
AUDIT REPORT



DECATUR MORTGAGE COMPANY, L.L.C.
NON-SUPERVISED LOAN CORRESPONDENT

INDIANAPOLIS, INDIANA

2004-CH-1009

September 23, 2004

OFFICE OF AUDIT, REGION V
CHICAGO, ILLINOIS



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| Issue Date | September 23, 2004 |
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TO: John C. Weicher, Assistant Secretary for Housing-Federal Housing Commissioner and Chairman of Mortgagee Review Board, H
Margarita Maisonet, Director of Departmental Enforcement Center, CV

Thomas M. Towers

FROM: Tom Towers, Acting Regional Inspector General for Audit, 5AGA

SUBJECT: Decatur Mortgage Company, L.L.C.
Non-Supervised Loan Correspondent
Indianapolis, Indiana

We completed an audit of Decatur Mortgage Company, L.L.C., a non-supervised loan correspondent approved to originate FHA single-family mortgage loans. We selected Decatur for audit because it had a high loan default rate. Our audit objectives were to determine whether: Decatur acted in a prudent manner and complied with HUD's regulations, procedures, and instructions in the origination of FHA loans; and Decatur's Quality Control Plan as implemented met HUD's requirements. The audit resulted in two findings.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (313) 226-6280 extension 8062.



Executive Summary

We completed an audit of Decatur Mortgage Company, L.L.C., a non-supervised loan correspondent approved to originate FHA mortgage loans under HUD's Single Family Direct Endorsement Program. The audit was part of the activities in our Fiscal Year 2003 Annual Audit Plan. We selected Decatur for audit because of its high loan default rate. Our audit objectives were to determine whether: (1) Decatur acted in a prudent manner and complied with HUD's regulations, procedures, and instructions in the origination of FHA loans; and (2) Decatur's Quality Control Plan as implemented met HUD's requirements.

We concluded that Decatur Mortgage Company did not adhere to prudent lending practices and comply with HUD's regulations, procedures, and instructions when it originated FHA-insured loans. This was due in part to Decatur's reliance on its managing owner to perform management oversight and a failure to ensure that its Quality Control Plan was adequately implemented. We cited the sponsor's responsibilities, as well as Decatur's, and recommended appropriate corrective actions.

HUD's Quality Assurance Division reviewed Decatur's loan originations in September 2002 and cited similar issues. Eight of the 41 loans we reviewed were included in HUD's review and are identified in Appendix B of this report.

Improvements Needed In The Origination Of FHA- Insured Loans

Decatur did not originate FHA-insured loans in accordance with HUD's requirements and prudent lending practices. Decatur did not exercise due diligence to: (1) verify or support borrowers' income level and stability; (2) ensure unbiased appraisals were provided; (3) investigate credit inquiries and additional Social Security Numbers shown on credit reports; (4) establish the borrower's ability and willingness to pay; (5) document the source of deposits and gift funds—and not use gift funds to pay-off borrower's debts; (6) estimate borrower's expenses and property taxes; and (7) not allow interested third parties to handle key documentation.

Management Oversight And Inadequate Quality Control Reviews

Decatur did not ensure that Quality Control Reviews were completed on FHA loans as required. Specifically, Decatur did not: (1) perform Quality Control Reviews on early default FHA loans as required; (2) document work done to determine if loans were originated properly; and (3) identify origination deficiencies and corrective actions needed for its loan originations.

Recommendations

We recommend that HUD's Assistant Secretary for Housing-Federal Housing Commissioner and Chairman of the Mortgagee Review Board require Decatur's sponsors to indemnify HUD/FHA for any losses. We also recommend that HUD's Director of Departmental Enforcement Center

take appropriate administrative actions against the owners of Decatur.

We provided our draft audit report to Decatur's Chief Executive Officer and its two sponsors, and HUD's staff during the audit. We held an exit conference with Decatur's Chief Executive Officer on August 13, 2004. Decatur's owners provided written comments to our draft report on August 13, 2004. Decatur's owners generally disagreed with the findings in this report. The complete text of Decatur's comments is included in Appendix E of this report. We removed borrower names from Decatur's comments as necessary.

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Introduction

Section 203(b)(1) of the National Housing Act, as amended, authorizes HUD to provide mortgage insurance for single-family homes. HUD must formally approve a mortgagee that originates, purchases, holds, or sells FHA-insured loans. Mortgagees must follow the statutory and regulatory requirements of the National Housing Act and HUD's instructions, guidelines, and regulations when originating insured loans. Mortgagees that do not follow these requirements are subject to administrative sanctions.

In March 2000, HUD approved Decatur Mortgage Company as a non-supervised loan correspondent mortgagee to originate FHA loans. As a condition for its HUD approval, Decatur was required to have and maintain a Quality Control Plan for the origination and servicing of insured loans. The Quality Control Plan must be a prescribed function of Decatur's operations and assure that it maintains compliance with HUD's requirements and its own policies and procedures.

As a loan correspondent, Decatur must send the FHA loans it originates to a HUD-approved Direct Endorsement sponsor(s) for underwriting approval prior to loan closing and submission to HUD for insurance endorsement. The loan origination process includes taking initial loan applications, initiating the appraisal assignment, obtaining the credit report, and procuring verifications of deposit and employment. Based on the information gathered by the loan correspondent, the sponsor mortgagee underwrites the loan and makes a decision whether the borrower represents an acceptable credit risk for HUD. Since the sponsor bases its underwriting approval, in large part, on information gathered by the loan correspondent, it is critical that the loan correspondent exercises due care and follows prudent lending practices and HUD's requirements when originating the loan.

Decatur had a home office and a branch office in Indianapolis, Indiana. Decatur was part owned by Dura Homes, Incorporated (affiliated with Dura Builders who built and sold all of the mortgaged properties) and Homebuilders Financial Network (who managed Decatur as well as other similar loan correspondents established and owned by various homebuilders across the nation).

HUD terminated Decatur's home office on June 23, 2003 due to its high default rate. Decatur voluntarily closed its branch office in November 2003, at the direction of Homebuilder's Financial Network. Decatur originated 506 FHA-insured single-family loans totaling about \$70 million during the period September 2001 through August 2003. The Chief Executive Officer of Decatur was Thomas H. Meyer (President of Homebuilders Financial Network). The President of Decatur was Paul Shoopman (President of Dura Builders, Incorporated and Dura Homes, Inc.).



Audit Objectives

Our audit objectives were to determine whether: Decatur acted in a prudent manner and complied with HUD's regulations, procedures, and instructions in the origination of

Audit Scope And
Methodology

FHA loans; and Decatur's Quality Control Plan, as implemented, met HUD's requirements.

We conducted the audit at Decatur's branch office and HUD's Detroit Field Office. We performed our audit work from September 2003 through May 2004.

To accomplish our objectives, we interviewed: HUD's staff; Decatur's management and employees; and loan borrowers. We also contacted the employers of the loan borrowers. In addition, we spoke to a representative of one of the sponsors (National City Mortgage) regarding the defaulted loans originated by Decatur.

We reviewed HUD's loan origination, Quality Control Plan, and Quality Control Review requirements. We also reviewed Decatur's Quality Control Plan for adequacy and consistency with HUD's requirements.

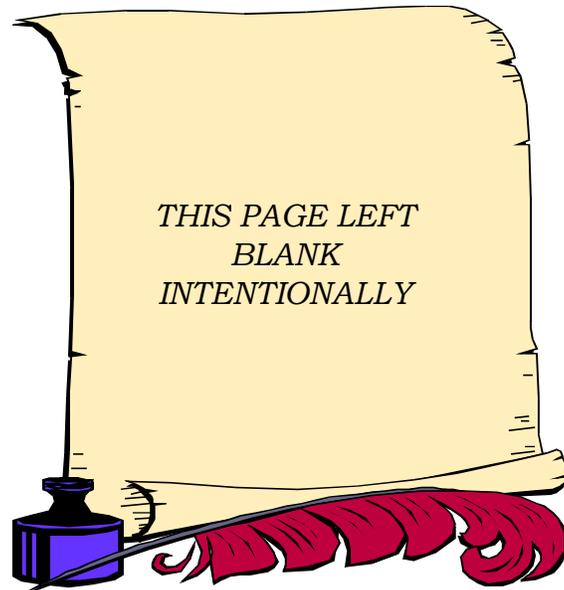
We analyzed all 14 loans identified as early default cases to determine if Decatur conducted the required Quality Control Reviews. We also reviewed the three defaulted loans that Decatur's managing owner performed Quality Control Reviews on as of October 1, 2003, to determine if Decatur performed the Reviews in accordance with its Quality Control Plan and HUD's requirements.

We tested Decatur's loan origination process using all loans that closed during the period September 2001 through August 2003 that subsequently went into default as of October 2003. Using HUD's Neighborhood Watch System, we selected a non-representative sample of all 41 loans that went into default from a universe of 506 FHA-insured loans. We tested Decatur's origination process through a review of HUD's FHA Case Binders and Decatur's loan origination files related to our sample.

The audit covered the period from September 2001 through August 2003. The period was adjusted as necessary. We conducted the audit in accordance with Generally Accepted Government Auditing standards.

We provided copies of this report to Decatur's President and Chief Executive Officer. We also furnished copies to Decatur's sponsors—the President of National City

Mortgage and the Office Manager at Prime Mortgage Company.



Improvements Needed In The Origination Of FHA-Insured Loans

Decatur Mortgage Company, L.L.C. did not originate FHA-insured loans in accordance with HUD's requirements and prudent lending practices. In all 41 loans reviewed, Decatur did not exercise due diligence to: 1) verify or support borrowers' income level and stability; 2) obtain unbiased appraisals; 3) investigate credit inquiries and additional Social Security Numbers on credit reports; 4) establish the borrower's ability and willingness to pay; 5) document the source of deposits and gift funds, and not allow the use of gift funds to pay-off borrower debts; 6) estimate borrower expenses and property taxes; and 7) not allow interested third parties to handle key documentation. The deficiencies associated with Decatur's loan origination activities stemmed from: Decatur's partial ownership by the builder of homes for whose loans Decatur was established to handle; a lack of management oversight; and a failure to implement an adequate Quality Control process. These deficiencies contributed to the high loan default and claim rate, putting at risk over \$5.1 million in FHA-insured loans.

HUD's Requirements

Under Section 203 of the National Housing Act (Title 12 of United States Code Section 1709), HUD insures mortgages made by private lending institutions. Depending on their designation by HUD, the institutions have the authority to originate, purchase, sell, or service HUD/FHA-insured mortgages. As a loan correspondent, Decatur's principal activity is the origination of mortgages for sale or transfer to an approved sponsor under HUD's Single Family Direct Endorsement Program.

Fourteen Services/Functions Performed During Loan Origination

The Federal Register dated March 1, 1999, addressing HUD's regulation 24 CFR Part 3500 (Real Estate Settlement Procedures Act), referred to HUD's letter to the Independent Bankers Association of America, dated February 14, 1995. The letter identified 14 services/functions normally performed in the origination of a loan. The services/functions entail, but are not limited to the following:

- Obtain information from the borrower and complete the mortgage loan application/comparable activity;
- Analyze the prospective borrower's income and debt, and pre-qualification to determine the maximum mortgage amount the borrower can afford;
- Educate the prospective borrower in the home buying and financing process;

- Collect financial information (tax returns, bank statements) and other related documents that are part of the application process;
- Initiate/order verifications of employment and verifications of deposit;
- Initiate/order requests for mortgage and other loan verifications;
- Initiate/order appraisals;
- Initiate/order inspections of engineering reports;
- Provide disclosures (truth in lending, good faith estimate, others) to borrower;
- Assist the borrower in understanding and clearing credit report problems;
- Maintain regular contact with the borrower, realtors, and lender between application closing;
- Order legal documents;
- Determine whether the property is located in a flood zone or order such service; and
- Participate in the loan closing.

Paragraph 2-5 of HUD Handbook 4000.4 REV-1, Single Family Direct Endorsement Program, provides that the mortgagee must obtain and verify information with at least the same care that would be exercised in originating the loan where the mortgagee would be entirely dependent on the property as security to protect its investment.

Based on the information contained in the loan package received from the loan correspondent, the underwriter (sponsor) will approve or reject the loan, or approve the loan if certain conditions are met. Therefore, it is critical that the loan correspondent exercises due diligence and follows prudent lending practices during the loan origination process.

Deficiencies In Loan Originations

Decatur Mortgage Company did not originate FHA-insured loans in accordance with HUD's requirements and prudent lending practices. We reviewed 41 FHA loans originated by Decatur with a total dollar value of \$5,827,404. We selected our non-representative sample from a universe of 506 FHA loans with closing dates between September 2001 and August 2003.

Income Was Not Properly Verified Or Supported

Decatur Mortgage did not properly verify or support borrower's income on 18 FHA loans by not obtaining the income documentation required by HUD Handbook 4155.1

REV-4 CHG-1, paragraph 2-7. These deficiencies included use of rental income of other properties owned that was not verified (3 of 18 loans) and use of overstated or unstable borrower income (17 of 18 loans). Two cases had both issues.

For FHA Case number 151-6605466, Decatur did not adequately verify rental income on the borrower's current residence. Decatur provided a copy of a rental agreement for the borrower's current address dated the same day as the subject sales agreement. The rental agreement showed monthly rent payments of \$650 and a copy of an August 2000 check was provided, but no cancellation was shown. A Credit Union Draft History in the loan file through August 30, 2000 did not show any deposits of \$650 to support that the rent payments were actually being received. The initial Loan Application, dated June 20, 2002, did not show rental income despite the June 16, 2002 rental agreement.

In an interview, the borrower said the seller's sales staff provided her with a lease form. The borrower filled out the lease form and had her son's girlfriend sign the lease and provide a rent check. The sales staff knew the lease was invalid. After the sales staff copied the rent check, the borrower threw the check out. The borrower never actually received rent for her prior residence. The borrower just stopped making the mortgage payments on her prior residence. The borrower said no one at Decatur asked her about her income, debts, or the lease for the prior residence.

For FHA Case number 151-6542156, Decatur included social security benefits received as other income for the borrower's two children, ages 16 and 17. The social security benefit letter was provided in both the HUD and mortgage files showing that total social security benefits were \$716. However, Decatur and the underwriter used an amount that was increased (grossed up) 25 percent without documentation on why they did so.

Income verification or documentation issues for the remaining 16 FHA cases are explained in Appendix C of this report. It was Decatur's responsibility to verify and support borrower incomes but the sponsor's responsibility for the actual loan approvals.

Appraisal Reports Were Not Properly Analyzed Or Supported

Decatur Mortgage Company did not provide adequately documented and unbiased appraisal reports acceptable in accordance with HUD Handbook 4150.2, Sections 4-1, 4-6 and 7-1.

We noted 32 cases where appraisers used comparable properties that were either: 1) over a mile from the subject property; 2) were sold more than six months prior to the appraisal without adequate explanation; or 3) comparable properties selected from the same subdivision as the subject property, and were manufactured and sold by the same builder as the subject property. The same appraiser was used in 39 of the 41 cases reviewed.

In five cases, (151-6486054, 151-6567251, 151-6561313, 151-6485246, and 151-6589970) the appraiser adjusted the appraised value upwards when the sales price of the subject property was increased. We discuss the remaining 27 cases in Appendix C of this report.

It was Decatur's responsibility to obtain proper and unbiased appraisals for submission to the sponsor's underwriters. It was the responsibility of the underwriter to evaluate the appraisals to ensure that the value supported the mortgage.

Credit Inquiries And Additional Social Security Numbers On Credit Reports Were Not Investigated

In 27 of the 41 cases, we identified issues relating to credit reports that were not adequately investigated by Decatur Mortgage's employees. These issues related to credit inquiries shown on the credit report or credit reports identifying additional Social Security numbers for one of the borrowers that was not investigated. Three cases (151-6550730, 151-6443404, and 151-6838872) had both issues. In 10 of 27 cases, additional Social Security numbers were identified but not investigated, and in 20 of the 27 cases, credit inquiries were not investigated. The 27 cases are discussed in Appendix C of this report.

Paragraph 2-3 of HUD Handbook 4155.1 REV-4 CHG-1, states when reviewing the borrower's credit report, the lender must pay particular attention to recent and/or undisclosed debts. The borrower must explain all inquiries shown on the credit report. Paragraph 3-2 (c) requires that lenders obtain Social Security evidence for each borrower and co-borrower.

It was Decatur's responsibility to investigate credit inquiries and additional Social Security numbers during the processing

of the loan applications. It was the sponsor's underwriters' responsibility to review the documentation provided by Decatur and not approve loans until such discrepancies were adequately resolved.

Borrower's Ability And
Willingness To Pay Not
Established

In 36 of the 41 loans, we identified issues relating to the borrowers ability to afford the mortgage and living expenses, and 22 cases had more than one of these issues. These issues included: (1) the underwriter not providing adequate compensating factors for loans with credit ratios exceeding HUD's guidelines (12 of 36 cases); (2) underwriters not adequately explaining how borrowers would be expected to meet mortgage obligations as buy-down agreements expired (23 of 36 cases); and (3) not adequately establishing how borrowers improved their credit worthiness other than having delinquencies paid off from closing proceeds (28 of 36 cases). These 36 cases are discussed in Appendix C of this report.

Paragraph 2-1 of HUD Handbook 4155.1 REV-4 CHG-1, Mortgage Analysis for Mortgage Insurance on One-to-Four Family Properties, requires mortgagees to determine the borrower's ability and willingness to repay the mortgage debt, and thus limit the probability of default or collection difficulties. Four major elements are typically evaluated in assessing a borrower's ability and willingness to repay the mortgage debt. These include the stability and adequacy of income, funds to close, credit history, and qualifying ratios and compensating factors. Paragraph 3-1 of the Handbook states HUD expects the application package to contain sufficient documentation to support the lender's decision to approve the mortgage loan.

It was Decatur's responsibility to obtain and provide documentation and information to the sponsor's underwriter. Decatur submitted loans to the underwriters with understated property taxes and where delinquent debts were being paid off out of closing proceeds. It was the underwriter's responsibility to analyze the loans and document the compensating factors used to approve loans exceeding HUD's guideline ratios. The underwriters were also responsible for approving borrowers with bad payment histories and using understated expenses in the mortgage credit analysis.

Inadequate
Documentation Of
Deposits

Decatur Mortgage lacked support to show it properly verified the borrowers' sources of funds to close. In 40 of the 41 cases reviewed, we noted issues relating to the lack of adequate documentation of deposits provided by the borrowers and provision of gift funds by non-profit donors.

In 34 of 41 cases, Decatur did not adequately verify the actual source of deposits provided by the borrowers. Decatur did not provide cancelled checks and bank statements to show the cash deposits coming out of the borrowers' accounts.

In 39 of 41 Cases, Decatur did not document the timing of the gift wire transfers from non-profit donors to the settlement agent and the timing of the contribution from seller's proceeds back to the nonprofit donor to ensure that the gift funds were not actually provided by the seller. The settlement agent was not able to provide us actual documentation of the wire transfers. The settlement agent's bank provided us with the wire transfer documentation.

The documentation we obtained showed that in one case (151-6463779), the settlement agent transferred \$9,181 of the seller's proceeds to the Housing Action Resource Trust on September 14, 2001—the day of closing—but did not receive the \$8,231 gift from the Trust until September 17, 2001 (three days later). The seller provided the gift funds in violation of HUD's requirements.

For FHA Case number 151-6510827, receipts in Decatur's loan file show that the borrower gave a \$10,000 earnest money deposit which was not reflected on the HUD-1 Settlement Statement or otherwise explained.

In 23 cases, the settlement agent paid off more of the borrowers' delinquent debts than cash provided by the borrowers. This caused part of the gifts provided by nonprofit donors to be used to pay off delinquent accounts rather than being used for the home purchase transactions. The sales prices and mortgages were not reduced due to the gift funds being used to pay off the borrower's delinquent debts.

Paragraph 2-10, Funds To Close, HUD Handbook 4155.1 REV-4 CHG-1, requires that all funds for the borrower's investment in a property be verified. Lenders are required to verify the deposit amount and source of funds if earnest money deposits are excessive based on the borrower's

savings history. For gifts, the lender must document the transfer of funds from the donor to the borrower. If the funds are not deposited to the borrower's account prior to closing, the lender must obtain verification that the closing agent received the funds from the donor for the gift amount. The donor of the gift may not be a person or entity with an interest in the sale of the property such as the seller, real estate agent or broker, builder, or entity associated with them. Gifts from these sources are considered inducements and must be subtracted from the sales price.

Sponsors rely on information prepared and collected by loan correspondents in determining the eligibility of borrowers to qualify for loans. When irregularities occur with respect to gift funds due to lenders not complying with HUD's requirements, there may be grounds for administrative action and referral to HUD's Mortgagee Review Board for imposition of administrative sanctions or civil money penalties against loan correspondents and/or sponsors.

It was Decatur's responsibility to determine and document the source of funds provided on behalf of the borrowers during loan processing. This includes determining how the gift funds were being provided at closing. It was the responsibility of the sponsor's underwriters to not approve loans when Decatur had not properly demonstrated the source of the funds provided, and for allowing gift funds to be used at closing to pay off borrower's bad debts.

Borrower Expenses And
Property Taxes Were
Underestimated

In 37 of the 41 Cases reviewed, Decatur Mortgage Company and the underwriter underestimated the borrower's expenses and property taxes. Twelve of the 37 cases had an expense indicated in a file document not considered in the mortgage credit analysis.

In 36 cases, Decatur and the underwriter estimated a monthly figure for property taxes that was based on the taxes for the undeveloped land. The actual taxes to be assessed after sale to the buyers were significantly higher and were not figured in to the borrowers' ability to afford the mortgage. Generally, the estimate Decatur used for property taxes was either \$25 or \$40 per month, but the actual taxes ranged between \$72 and \$279 per month based on information obtained from the counties where the properties were located.

Paragraph 2-12 of HUD Handbook 4155.1 REV-4 CHG-1 requires lenders to compute two ratios to determine if the borrower can reasonably be expected to meet the expenses of home ownership and provide for the family: 1) mortgage payment expense to effective income (29 percent limit unless significant compensating factors are present); and 2) total fixed payment to effective income (41 percent limit unless significant compensating factors are present).

It was Decatur's responsibility to identify and disclose all liabilities and expenses of the borrowers to be provided to the sponsor for underwriting. This included reasonable estimates of property taxes and other expenses that borrowers would be expected to pay. In the loan applications, Decatur provided an unreasonably low estimate of property taxes. It was the underwriter's responsibility to review the documentation provided and adjust it as necessary for mortgage credit analysis based on the documentation available.

Interested Third Parties
Handled Key
Documentation

In 10 cases, Decatur obtained wage information, verification letters, and letters of explanations about income and debts from interested third parties. These documents in the loan files (151-6605466, 151-6561313, 151-6485246, 151-6574687, 151-6476579, 151-6482988, 151-6589970, 151-6507102, 151-6415426, and 151-6584264) showed that they were faxed either from one of the seller's sales offices or from the borrowers' place of employment rather than directly from the source. In three cases (151-6605466, 151-6574687, and 151-6589970), explanation letters were provided that were created for the borrowers by the seller's sales staff and contained incorrect information according to the borrowers.

HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1, states verification forms must pass directly between the lender and the provider without being handled by any third party. These include explanatory statements or additional documentation needed for a sound underwriting decision.

As a loan processor, it was Decatur's responsibility to obtain documentation directly from borrowers, employers or other sources directly without the documents passing through the hands of interested parties such as the seller. It was the sponsor's responsibility to not accept documents that show evidence that an interested party provided them.

Lack Of Management Oversight And A Deficient Quality Control Process

The deficiencies associated with Decatur Mortgage’s loan origination activities stemmed from: Decatur’s partial ownership by the builder of the homes for whose loans Decatur was formed to handle; a lack of management oversight; and a failure to implement an adequate Quality Control Plan. Decatur was responsible for its own management oversight, but failed to take this responsibility seriously. Decatur also failed to implement an adequate Quality Control Plan and conduct effective Quality Control Reviews of its loan origination practices (see Finding 2). Had it been implemented, Decatur could have prevented various loan origination deficiencies that ultimately resulted in loans going into default. Additionally, it would have allowed Decatur to correct deficiencies in its loan origination process and prevent repeated occurrences of problems.

Decatur’s loan origination deficiencies contributed to the high loan default and claim rate of 8.1 percent during the period September 2001 through August 2003. These deficiencies increased the risk to the FHA insurance funds by \$5,101,822 (\$675,063 in ineligible, \$356,723 in unsupported costs, and \$4,070,036 in funds at risk that could be put to better use).

Current Status Of Loans With Deficiencies

The status of the 41 loans in default—as of September 3, 2004—is reflected in the following table:

| <i>Status</i> | <i>Mortgage Amount</i> | <i>Number of Loans</i> |
|--|---------------------------|------------------------|
| Currently in Default | \$4,070,036 | 28 |
| Claim Paid & Property Resold at Loss | \$675,063 | 11 |
| Claim Paid but Property Not Resold | \$336,706 | <u>2</u> |
| Partial Claims Paid on 8 loans in default (non foreclosure) ^{1/} | <u>\$20,017</u> | <u>^{1/}</u> |
| Totals | <u>\$5,101,822</u> | <u>41</u> |

^{1/} Included in the 28 loans in default.

As of September 3, 2004, HUD paid claims on 13 FHA loans totaling \$1,904,495 and incurred a total loss of \$675,063 on the resale of 11 of these 13 properties. The remaining two properties accounted for \$336,706 of the claims paid. HUD had not resold these properties as of our audit date, so the total loss to HUD was unknown. HUD

Finding 1

also paid non-foreclosure partial claims on eight loans totaling \$20,017.

The following table shows the 11 loans with ineligible costs due to losses incurred by HUD after foreclosure resale.

| FHA Loan Number | Sponsor Number | Foreclosure Sale Loss |
|-----------------|----------------|-----------------------|
| 151-6531249 | 38092 | \$60,944 |
| 151-6550730 | 38092 | \$67,282 |
| 151-6415426 | 38092 | \$59,696 |
| 151-6463779 | 38092 | \$67,530 |
| 151-6476579 | 38092 | \$64,912 |
| 151-6482988 | 38092 | \$51,981 |
| 151-6486185 | 38092 | \$56,963 |
| 151-6507102 | 38092 | \$58,437 |
| 151-6527323 | 38092 | \$70,131 |
| 151-6584264 | 38092 | \$55,089 |
| 151-6584501 | 38092 | \$62,098 |
| | Total | <u>\$675,063</u> |

The following table shows the two loans with unsupported costs due to full claim filed but property not yet sold.

| FHA Loan Number | Sponsor Number | Claim Paid Loss Not Determined |
|-----------------|----------------|--------------------------------|
| 151-6483461 | 38092 | \$174,454 |
| 151-6567251 | 38092 | \$162,252 |
| | Total | <u>\$336,706</u> |

The following are the eight loans in default where HUD paid partial non-foreclosure claims to the loan servicer to avoid foreclosure.

| FHA Loan Number | Sponsor Number | Partial Claim Paid | Type Of Claim |
|-----------------|----------------|--------------------|-----------------------|
| 151-6907158 | 73850 | \$750 | Loan Modification Fee |
| 151-6561313 | 38092 | 650 | Loan Modification Fee |
| 151-6574687 | 38092 | 12,233 | Partial Claim |

| | | | |
|-------------|-------|-----------------|-------------------------------------|
| 151-6471089 | 38092 | 650 | Loan Modification Fee |
| 151-6443404 | 38092 | 100 | Forbearance Fee |
| 151-6649076 | 38092 | 850 | Loan Modification Fee |
| 151-6476419 | 38092 | 4,034 | Partial Claim & Special Forbearance |
| 151-6486054 | 38092 | <u>750</u> | Loan Modification Fee |
| Total | | <u>\$20,017</u> | |

Decatur and Sponsor Responsibilities

HUD Handbooks 4000.4 REV-1 and 4060.1, and 24 CFR Part 202.8 state sponsors are responsible to HUD for the actions of its loan correspondents. Sponsors can rebut the presumption that they have specific knowledge of the actions of the loan correspondent when there is evidence of fraud, for example.

In the deficiencies we cited, only the failure to provide compensating factors for excessive mortgage credit ratios, and approval of loans for borrowers with pre-existing bad debt was solely the responsibility of the sponsors.

Decatur was responsible for: 1) failing to adequately verify or support income; 2) acceptance of questionable appraisal practices; 3) failure to investigate credit inquiries; 4) failure to demonstrate credit worthiness; 5) failure to show the timing of gift transfers to and from nonprofit donors; 6) the use of gift funds to pay off bad debts; 7) failing to document the source of funds provided; 8) understating living expenses and property taxes; and 9) allowing interested third parties to provide wage information and explanatory letters.

These deficiencies represent actions by Decatur that its sponsors should have had specific knowledge of. As such, the sponsors were responsible to HUD for giving underwriter approval to the loans originated and processed by Decatur, and should be pecuniarily responsible for loans that were not processed in accordance with HUD's requirements and prudent lending practices. In September 2002, HUD's Quality Assurance conducted a review of Decatur and identified many of the same deficiencies we identified. In fact, eight of the loans were included in our scope of 41 loans. National City Mortgage agreed to indemnify HUD on losses

associated with these eight loans. HUD should seek indemnification agreements on the remaining loans, except where we are recommending reimbursement for any claims already paid by HUD/FHA.

Decatur's Operations
Were Terminated

On March 20, 2003, HUD notified Decatur that its home office was having its lender approval status terminated due to an excessive loan default rate. Decatur's home office terminated operation on June 23, 2003. In October 2003, Decatur's managing owner, Homebuilders Financial Network, informed us that it was voluntarily closing its remaining branch office by the end of 2003. Decatur's managing owner terminated the office staff at the end of October and closed its office in November 2003.

Auditee Comments

Decatur's owners disagreed with this finding. The owners asserted that they provided adequate management oversight and never submitted documentation that they knew to be deficient. The owners stated that as a loan correspondent, Decatur did loan processing by obtaining information and the sponsor's underwriters were responsible for the analysis of the documentation provided. The owners maintain that the issues we cited were underwriting issues that should be addressed with the sponsors.

The complete response as provided by Decatur's owners is included in its entirety in Appendix E of this report. We removed the names of individual borrowers from the response.

OIG Evaluation Of
Auditee Comments

We disagree that Decatur's owners adequately oversaw operations as we discussed in the second finding of this report. We agree that the sponsors are primarily responsible to HUD/FHA for the actions of its loan correspondents and for the underwriting approval decisions.

As a loan correspondent, Decatur Mortgage Company was responsible to HUD/FHA and the sponsors for the application process and obtaining and processing documentation in accordance with FHA requirements and prudent lending practices. To a large degree, the sponsors rely on information

provided by loan correspondents in performing the underwriting analysis.

As we cited in the first finding, Decatur processed loan applications that overstated or provided unverified income and understated expenses. Decatur also did not adequately document the actual source of borrower funds and allowed gift funds provided by non-profit donors to be used to pay-off delinquent debts of the borrowers. Decatur allowed interested third parties to provide documentation and tended to use the same appraiser for its loans. Although the sponsor is primarily responsible to HUD, our analysis of Decatur's delinquent loans as a whole did not show that Decatur's staff used prudent loan origination practices to gather information for the sponsor's underwriters. We modified our finding to clarify lender responsibilities and our recommendations. Our full analysis of Decatur's response to our report is included in Appendix E of this report.

Recommendations

We recommend that HUD's Assistant Secretary for Housing-Federal Housing Commissioner and Chairman of the Mortgagee Review Board:

- 1A. Requires Decatur Mortgage's sponsors to reimburse HUD for \$675,063 in losses on the 11 resold properties.
- 1B. Requires Decatur Mortgage's sponsors to reimburse the appropriate amount of \$20,017 for the eight partial claims as well as any losses incurred on the two properties for which HUD paid foreclosure claims totaling \$336,706, but had not yet resold.
- 1C. Requires Decatur Mortgage Company's sponsors to indemnify HUD/FHA against future losses on the 28 loans totaling \$4,070,036 that are in default, but not yet foreclosed.
- 1D. Notifies HUD's Office of Lender Approval and Recertification Division of the determination by the Mortgagee Review Board regarding Decatur Mortgage Company and its owners as to violations of HUD's requirements and prudent lending practices.

If determined that Decatur's owners can reapply for a new FHA license as a non-supervised loan correspondent, then HUD's Assistant Secretary for Housing-Federal Housing Commissioner and Chairman of the Mortgage Review Board should:

- 1E. Ensures that Decatur's owners implement adequate procedures and controls to comply with HUD's requirements for the origination of FHA-insured single-family mortgage loans.

We recommend that HUD's Director of Departmental Enforcement Center:

- 1F. Takes appropriate administrative action against the owners of Decatur Mortgage Company.
- 1G. Obtains a qualified review of the appraisals done for the 41 cases cited in this report to determine if the appraiser properly arrived at a fair property valuation and appropriately raised values when the sale prices changed due to changing gift amounts. If the appraisals are found to be deficient, take appropriate administrative action against the appraiser.

Inadequate Management Oversight And Quality Control Reviews

Decatur Mortgage Company failed to adequately implement its Quality Control process according to HUD's requirements. Decatur Mortgage did not review 14 loans that defaulted within the first six payments after closing. In addition, Decatur did not adequately document what procedures it performed for the FHA mortgage loans reviewed. We attribute these deficiencies to Decatur's inability to access HUD's Neighborhood Watch system, an ownership relationship with the seller of the subject properties, and a disregard of HUD's and its own quality control requirements. As a result, Decatur was unable to ensure the accuracy, validity, and completeness of its loan origination operations that contributed to an increased risk of loss to HUD's FHA insurance fund.

HUD Requirements

HUD Handbook 4060.1 REV-1, Mortgagee Approval Handbook, includes the requirements for a mortgagee's Quality Control Plan for the origination and servicing of FHA-insured mortgages. Chapter 6 of the Handbook provides the general requirements along with mortgagee type specific requirements for Quality Control plans. The Handbook requires mortgagees to:

- Establish an adequate written Quality Control Plan that provides for an independent review by the mortgagee's management/supervisory personnel who are knowledgeable of the required procedures, and do not have direct loan processing, underwriting, or servicing responsibilities;
- Analyze loans that go into default within six months after closing;
- Retain for a period of one year the results of quality control reviews, whether by the mortgagee or an outside firm;
- Report violations of law or regulation to HUD; and
- Include in their Quality Control Plan a provision for written verification of a mortgagor's employment, deposits, gift letter, or other sources of funds.

Decatur Mortgage Company, L.L.C., was owned by two entities in partnership. The managing owner was Homebuilders Financial Network. The other owner—Dura Homes, Inc., also known as Dura Builders—built and sold all of the homes financed through Decatur Mortgage.

Deficient Quality Control Reviews Done

Decatur Mortgage Company and its managing owner—Homebuilders Financial Network—did not conduct Quality Control Reviews for 14 early payment default loans as shown in the table below.

| FHA Loan Number | Mortgage Amount | Closing Date | Included In HUD's Review |
|-----------------|--------------------|--------------|--------------------------|
| 151-6605466 | \$152,605 | 9/5/2002 | |
| 151-6647913 | \$167,779 | 5/28/2002 | |
| 151-6387115 | \$164,328 | 10/19/2001 | |
| 151-6957663 | \$127,585 | 11/27/2002 | |
| 151-6531249 | \$126,672 | 11/30/2001 | |
| 151-6471089 | \$148,291 | 8/1/2002 | |
| 151-6415426 | \$119,922 | 9/14/2001 | X |
| 151-6476419 | \$167,779 | 11/19/2001 | X |
| 151-6476579 | \$130,935 | 11/19/2001 | X |
| 151-6482988 | \$120,785 | 11/8/2001 | X |
| 151-6486054 | \$143,115 | 11/21/2001 | X |
| 151-6486185 | \$110,229 | 9/19/2001 | X |
| 151-6542156 | \$153,924 | 11/5/2001 | |
| 151-6567251 | \$151,539 | 12/31/2001 | |
| Totals | \$1,985,488 | | <u>6</u> |

Six of the 14 early default loans in the table above were included in HUD's September 2002 Quality Assurance review.

In accordance with HUD Handbook 4060.1 REV-1, all loans going into default within the first six months must be reviewed as part of the Quality Control Plan's requirements. Until Decatur terminated operations in November 2003, it had relied on its managing owner to conduct the required Quality Control Reviews of its 14 early defaulted loans, but this was not done for any of the loans.

For reviews that were done, neither Decatur Mortgage nor its managing owner, Homebuilders Financial Network, were able to provide documentation on the procedures or

analyses performed, or what documentation was analyzed or verified. Decatur's managing owner did Quality Control Reviews on three out of the 41 mortgage loans we reviewed. In the three cases, the Reviews did not identify the origination issues that we found or recommend actions to resolve the deficiencies. These cases are shown in the following table (loan 151-6584501 was cited in HUD's September 2002 Quality Assurance review).

| Inadequate Quality Control Review Documentation For Reviews Done | | | | |
|--|-----------------|--------------|-------------------|--------------------------|
| FHA Loan Number | Mortgage Amount | Closing Date | Claim Paid By HUD | HUD's Computed Sale Loss |
| 151-6510827 | \$158,796 | 10/16/2001 | \$0 | \$0 |
| 151-6527323 | \$134,842 | 11/5/2001 | \$144,970 | \$70,131 |
| 151-6584501 | \$134,893 | 2/21/2002 | \$145,898 | \$62,098 |
| Totals | \$428,531 | | \$290,868 | \$132,229 |

Decatur's managing owner prepared a Quality Control Plan for Decatur Mortgage, but Decatur did not ensure that reviews were done in accordance with the Plan.

Decatur did not perform Quality Control Reviews of its loans because it stated that its managing owner—Homebuilders Financial Network—was responsible for conducting all of their quality control reviews based on information Decatur sent to them. This included loans originated during our audit scope—September 1, 2001 to August 31, 2003. Therefore, Decatur Mortgage was unable to ensure the accuracy, validity, and completeness of its loan origination operations.

Access To Information On Problem Loans

The Branch Operations Manager for Decatur Mortgage Company said Decatur's staff did not have access to HUD's Neighborhood Watch system to identify delinquent loans. He said Decatur did not monitor its own loans because it did not service them, and its sponsors did not report information on loan defaults back to Decatur. The staff at Homebuilders Financial Network also indicated that until mid 2002, they only had limited access to HUD's Neighborhood Watch system so they were not able to get detailed information about loans going into default.

We do not believe that these reasons relieved Decatur of its responsibility for ensuring that Quality Control Reviews were conducted on its originated loans. Absent of any knowledge of problem loans, Decatur should still have ensured that reviews were done. As a consequence, improper practices were allowed to continue, increasing the risk that more loans would go into default as discussed in Finding 1.

Auditee Comments

Decatur's owners disagreed with the second finding of this audit report.

Decatur's owners asserted that Decatur's Branch Manager oversaw the operations of Decatur's staff with management support of the managing owner Homebuilders Financial Network. The owners indicated that Homebuilders Financial Network performed quality control reviews over at least 10 percent of Decatur's loan originations each quarter in accordance with its approved Quality Control Plan.

Decatur's owners stated that they followed the requirements of the Quality Control Plan in all cases reviewed, but were not required by HUD to record the list of items reviewed or show the analysis done and documents verified in each case reviewed. HUD only requires quality control reports to identify any deficiencies noted.

The owners asserted that the deficiencies we identified in this report were underwriting issues that Decatur was not responsible for, and the Quality Control Reviews were not deficient because they did not identify these same issues. Decatur's owners also assert that they were not given access to early default information in HUD's Neighborhood Watch System until mid 2002.

We included Decatur's complete response to our report and the findings in Appendix E of this report. We deleted borrower's names from the response.

Although Decatur's owners state that they followed their approved Quality Control Plan, they provided no documentation to show that they did for the cases they reviewed.

HUD's Mortgagee Approval Handbook 4060.1 REV-1, dated September 1993, paragraph 6-3(D) requires the quality control reviewers to obtain new credit reports. Paragraph 6-3(E) requires the quality control plan to provide for the written reverification of the mortgagor's employment, deposits, gift letter, or other sources of funds. These requirements indicate that the quality control reviewer will be obtaining documentation needed to perform the reviews.

The sole documentation that Decatur's owners were able to provide for each loan reviewed was a one-page summary report showing that Decatur did a good job, or showing what minor problems were identified and corrected.

Decatur's owners stated that they did everything required by the Quality Control Plan for all loans reviewed, but provided no support for any of the loans reviewed. If a lender does not document what they did to verify whether the loan origination and processing was done correctly, HUD and the lender lack any real assurance that the lender was prudent in conducting its reviews.

We included our analysis of Decatur's complete response in Appendix E of this report following Decatur's response.

Recommendations

We recommend that HUD's Assistant Secretary for Housing-Federal Housing Commissioner and Chairman of the Mortgagee Review Board:

- 2A. Determines whether Decatur's deficiencies related to the Quality Control Reviews warrant any actions against Decatur's sponsors for not ensuring the required plan and reviews were effectively implemented by Decatur.

If determined that Decatur Mortgage Company is able to reapply for approval as an FHA lender, then HUD's Assistant Secretary for Housing-Federal Housing Commissioner should:

- 2B. Require Decatur Mortgage Company to take the needed actions to ensure the required Quality Control Plan reviews are conducted and corrective actions are taken and documented for all reported deficiencies.

Management Controls

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

We determined that the following management controls were relevant to our audit objectives:

- Program Operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above during our audit of Decatur Mortgage Company's loan origination practices and quality control process.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Significant Weaknesses

Based on our review, we believe the items on the following page are significant weaknesses:

- Program Operations

Decatur Mortgage Company did not operate its loan origination activities in accordance with HUD's Single Family Housing Program requirements. Specifically, Decatur did not: originate FHA-insured loans in accordance with HUD's requirements and prudent lending practices; and adequately implement its quality control process according to HUD's requirements (see Findings 1 and 2).

- Validity and Reliability of Data

Decatur violated HUD's requirements regarding FHA loan origination process (see Finding 1). Decatur did not adequately implement its policy for doing Quality Control Reviews (see Finding 2).

- Safeguarding Resources

Decatur failed to originate FHA-insured loans in accordance with HUD's requirements and prudent lending practices that exposed HUD to a risk to the FHA insurance fund (see Finding 1).

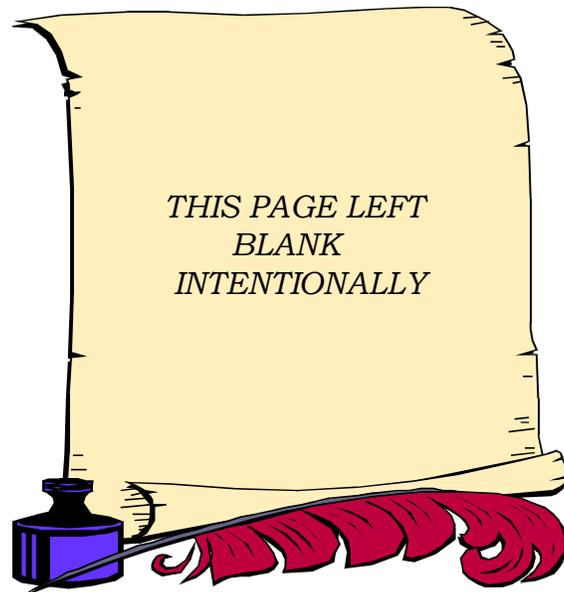
Follow Up On Prior Audits

This is the first audit of Decatur Mortgage Company, L.L.C. by HUD's Office of Inspector General.

The latest Independent Auditor's Report for Decatur covered the period ending December 31, 2002. The report did not contain any findings.

In September 2002, HUD's Quality Assurance Division conducted a Title II origination review of Decatur's home office in Indianapolis, Indiana. The review resulted in 10 findings to include: having a non-conforming Quality Control Plan; not performing Quality Control Reviews on early default loans; unverified source and adequacy of funds; documents being handled by interested third parties; inadequate documentation of gift transfers; failure to demonstrate the adverse affect of buy down expirations; inadequate income and employment documentation; not establishing borrower income stability; omitting liabilities and using unrealistic tax figures; and prudent underwriting not done in evaluating borrower credit histories. On May 5, 2003, the two findings relating to the Quality Control Plan were resolved.

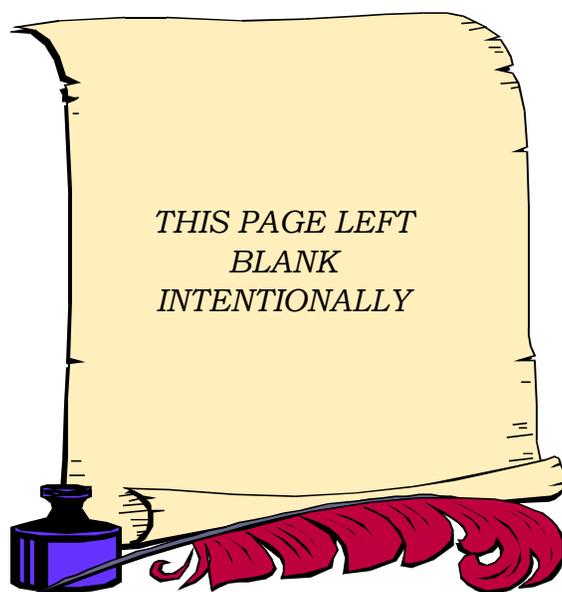
Eight of the 41 cases we reviewed were included in the September 2002 Quality Assurance Review. HUD and the sponsor for the eight loans, entered into an indemnification agreement including the eight loans we cited that were included in the Quality Assurance review. The indemnification agreement covering the eight loans was effective August 12, 2004.



Schedule Of Questioned Costs And Recommendation For Funds To Be Put To Better Use

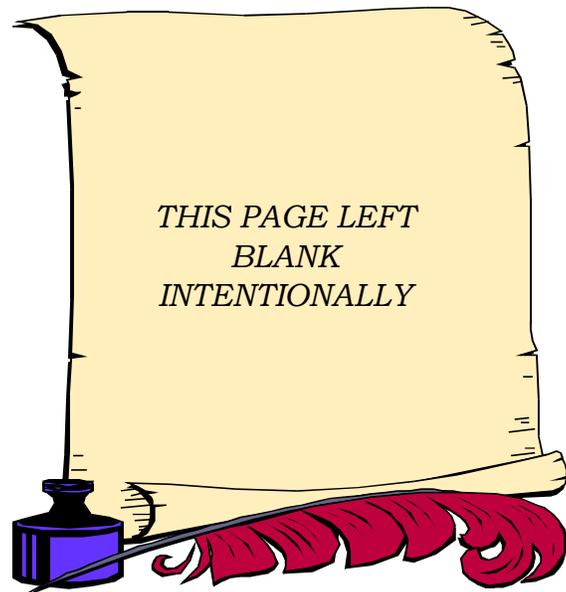
| Recommendation <u>Number</u> | Type of Questioned Cost | | Funds Put To <u>Better Use 3/</u> |
|---------------------------------|-------------------------|-----------------------|--------------------------------------|
| | <u>Ineligible 1/</u> | <u>Unsupported 2/</u> | |
| 1A | \$675,063 | | |
| 1B | | \$356,723 | |
| 1C | | | <u>\$4,070,036</u> |
| Totals | <u>\$675,063</u> | <u>\$356,723</u> | <u>\$4,070,036</u> |

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.
- 2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.
- 3/ Funds To Be Put To Better Use are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in a reduced expenditure in subsequent periods for the activity in question. Specifically, this includes an implemented OIG recommendation that causes a non-HUD entity not to expend Federal funds for a specific purpose. These funds could be reprogrammed by the entity and not returned to HUD.



Loan Processing Deficiencies Chart

| FHA Loan Number | Mortgage Amount | Closing Date | Income Issue | Appraisal Issue | Credit Report Issue | Ability To Pay Issue | Deposit/ Gift Issue | Under Stated Costs | Third Party Support | Sponsor | In HUD's September 2002 Review |
|-----------------|-----------------|--------------|--------------|-----------------|---------------------|----------------------|---------------------|--------------------|---------------------|---------|--------------------------------|
| 151-6605466 | \$152,605 | 9/5/2002 | X | X | X | X | X | X | X | 73850 | |
| 151-6647913 | \$167,779 | 5/28/2002 | X | X | | X | X | | | 73850 | |
| 151-6387115 | \$164,328 | 10/19/2001 | X | | X | X | X | | | 38092 | |
| 151-6396198 | \$132,559 | 9/24/2001 | X | X | X | X | X | X | | 38092 | |
| 151-6907158 | \$117,080 | 9/27/2002 | | X | X | X | X | X | | 73850 | |
| 151-6957663 | \$127,585 | 11/27/2002 | | | X | X | X | | | 73850 | |
| 151-6610262 | \$153,772 | 12/31/2001 | | | X | X | X | X | | 38092 | |
| 151-6442972 | \$144,637 | 9/24/2001 | | X | | X | X | X | | 38092 | |
| 151-6561313 | \$154,686 | 1/30/2002 | X | X | X | X | X | X | X | 38092 | |
| 151-6485246 | \$150,727 | 11/19/2001 | X | X | | X | X | X | X | 38092 | |
| 151-6510827 | \$158,796 | 10/16/2001 | | X | X | | X | X | | 38092 | |
| 151-6531249 | \$126,672 | 11/30/2001 | X | | X | X | X | X | | 38092 | |
| 151-6537560 | \$141,288 | 10/30/2001 | | X | | X | X | X | | 38092 | |
| 151-6550730 | \$133,980 | 11/15/2001 | X | X | X | X | X | X | | 38092 | |
| 151-6574687 | \$160,014 | 3/11/2002 | | X | X | X | X | X | X | 38092 | X |
| 151-6611721 | \$136,720 | 12/27/2001 | | X | X | X | X | X | | 38092 | |
| 151-6471089 | \$148,291 | 8/1/2002 | | | X | X | X | | | 38092 | |
| 151-6443404 | \$142,607 | 10/15/2001 | X | | X | | X | X | | 38092 | |
| 151-6838872 | \$167,728 | 8/30/2002 | X | X | X | X | X | X | | 38092 | |
| 151-6688221 | \$139,156 | 5/15/2002 | | X | | | X | X | | 38092 | |
| 151-6415426 | \$119,922 | 9/14/2001 | X | X | | X | X | X | X | 38092 | X |
| 151-6649076 | \$164,886 | 4/24/2002 | | X | X | X | X | X | | 38092 | |
| 151-6642980 | \$149,306 | 2/18/2002 | | X | X | X | X | X | | 38092 | |
| 151-6589970 | \$167,576 | 2/22/2002 | | X | X | X | X | X | X | 38092 | |
| 151-6463779 | \$138,852 | 9/14/2001 | X | X | X | X | X | X | | 38092 | |
| 151-6476419 | \$167,779 | 11/19/2001 | | | X | | X | X | | 38092 | X |
| 151-6476579 | \$130,935 | 11/19/2001 | X | X | X | X | X | X | X | 38092 | X |
| 151-6477778 | \$128,651 | 11/7/2001 | | X | | X | X | X | | 38092 | |
| 151-6482988 | \$120,785 | 11/8/2001 | X | X | X | X | X | X | X | 38092 | X |
| 151-6483461 | \$165,800 | 12/3/2001 | | X | X | X | X | X | | 38092 | |
| 151-6486054 | \$143,115 | 11/21/2001 | X | X | X | X | X | X | | 38092 | X |
| 151-6486185 | \$110,229 | 9/19/2001 | X | | | X | X | X | | 38092 | X |
| 151-6490797 | \$111,954 | 9/21/2001 | | X | | X | X | X | | 38092 | |
| 151-6494487 | \$105,864 | 11/28/2001 | | X | | | | X | | 38092 | |
| 151-6507102 | \$132,660 | 10/31/2001 | | X | X | X | X | X | X | 38092 | |
| 151-6527323 | \$134,842 | 11/5/2001 | X | X | X | X | X | X | | 38092 | |
| 151-6542156 | \$153,924 | 11/5/2001 | X | X | X | X | X | X | | 38092 | |
| 151-6567251 | \$151,539 | 12/31/2001 | | X | | X | X | X | | 38092 | |
| 151-6584264 | \$156,259 | 1/8/2002 | | X | | X | X | X | X | 38092 | |
| 151-6584501 | \$134,893 | 2/21/2002 | | | | X | X | X | | 38092 | X |
| 151-6588010 | \$116,623 | 3/11/2002 | | X | | X | X | X | | 38092 | |
| Totals | \$5,827,404 | | 18 | 32 | 27 | 36 | 40 | 37 | 10 | | 8 |



Narrative Case Presentations

FHA Case Number: 151-6605466

Mortgage Amount: \$ 152,605

Section of Housing Act: 203B

Date of Loan Closing: 09/05/02

Current Status: Active – Currently in default

Prior Status: Foreclosure Started 6/01/03 (Default Status Date: 07/30/04). No claim or loss determined.

Payments Before First Default Reported: 5

Unpaid Principal Balance: \$151,583

Summary:

The appraisal report issued by Appraiser VIDEWC dated January 11, 2002 was more than six months prior to the closing. The report was amended June 27, 2002, but the appraisal report does not indicate what was amended.

Decatur Mortgage did not verify the source of the earnest money deposit. On the date the \$1,000 check was written, the bank statement balance was less than \$10. The source of a \$1,000 deposit to the borrower's account two days later was not determined. The borrower informed us that the sales person provided her with the \$1,000 earnest money deposit since she did not have it.

Decatur did not document the timing of the \$4,652 gift fund transfer from the nonprofit donor, Nehemiah, to the Settlement Agent and the \$5,152 seller contribution back to the donor. The undocumented transfer from the donor occurred first.

Decatur did not verify rental income receipt for the prior residence not sold. The underwriter considered \$603 per month as the mortgage on the prior residence, but a Credit Union draft history indicated an automatic withdrawal for the mortgage of \$715. The rental agreement was dated the same day as the subject sales agreement. Monthly rental per the agreement and an uncancelled check copy were not deposited per bank statements. The borrower informed us the sales staff gave her a blank lease form that she filled out and had her son's girlfriend sign. The lease and the rent check used as support for not using the mortgage on the borrower's prior residence were not genuine documents. The borrower said she just quit paying the mortgage on her prior residence. The borrower also said she was not questioned about income, debts, or the lease by Decatur's staff.

The underwriter (#8968) estimated property taxes at \$144 per month. A March 9, 2002 tax bill in Decatur's file showed property taxes of \$1,456 for six months or approximately \$243 per month.

Decatur did not ascertain that the borrower had established good credit after a 1997 Chapter 7 Bankruptcy and the borrower would not be adversely affected as the buy down period expired. The credit reports showed 14 delinquent accounts after bankruptcy and the borrower was using a credit counselor to deal with delinquent accounts. Two delinquent accounts were paid off out of closing proceeds. The ratios computed by the underwriter were just under HUD's guidelines using the first year payment of the buy down period. A credit union draft history did not show any ability to save.

Decatur did not document any inquiry of the six credit inquiries on two credit reports. Decatur did not verify a credit union account from which transfers were indicated on a credit union statement in Decatur's file.

Letters from a credit counseling agency and the borrower's insurance company were faxed from the borrower's place of employment. The borrower informed us that she faxed the letters from the counseling agency and the insurance company, and she provided her W-2 forms and pay statements to the sales staff. The borrower informed us the sales staff had her sign blank pieces of paper that the sales staff used to write explanatory letters. The borrower said the explanatory letters were incorrect.

The underwriter used \$3,818 per month as income, but the verification of employment only supported \$3,668 per month.

This loan went into default after only five mortgage payments were received. Decatur's management did not identify this case as an early default and perform a quality control review on this loan.

FHA Case Number: 151-6647913

Mortgage Amount: \$ 167,779

Section of Housing Act: 203(b)

Date of Loan Closing: 05/28/02

Current Status: Delinquent, but reinstated by mortgagor (As of July 30, 2004).

Prior Status: Delinquent

Payments Before First Default Reported: 3

Unpaid Principal Balance: \$165,037.

Summary:

The Appraiser (JWM17R) did not adequately explain why she used two comparable properties that were older homes over a mile from the subject property and were sold more than six months earlier than the appraisal.

Decatur Mortgage did not verify the source of the earnest money deposit of \$1,718. The savings account did not show the funds coming out of the borrower's account. Decatur also did not adequately document the source of the \$5,000 money order gift funds from the borrower's Sister. No bank statements were provided to show where the cash came from to buy the bank cashiers check provided.

Decatur did not adequately establish that the borrower had established good credit after a 1996 bankruptcy. Credit reports showed derogatory credit and lack of money management ability since the bankruptcy. Delinquent borrower debt was paid from borrower proceeds at closing.

Decatur did not document the timing of the wire-transferred gift of \$5,154 from a non-profit donor, Nehemiah, and the seller's contribution of \$5,654 back to the donor. The gift transfer from the donor actually occurred first.

Decatur's file documents indicated that the co-borrower was receiving disability income prior to closing, but the underwriter (#8968) used the higher income from the co-borrower's employment. Decatur did not document the co-borrower's most recent pay stub.

This mortgage went into default after only three payments were received. Decatur's management did not identify this loan as an early default and perform a quality control review.

FHA Case Number: 151-6387115

Mortgage Amount: \$ 164,328

Section of Housing Act: 203(b)

Date of Loan Closing: 10/19/01

Current Status: Default – First legal action to foreclose started 10/1/02.

Prior Status: Not Applicable (status date July 30, 2004)

Payments Before First Default Reported: 5

Unpaid Principal Balance: \$163,299

Summary:

Decatur Mortgage did not verify the source of funds for the three Travelers Express Money Orders totaling \$1,748 for the earnest money deposit.

Decatur did not adequately show that the borrower established good credit after a June 1999 Chapter 13 Bankruptcy. Various delinquent accounts of the borrower were paid off at closing. More than \$1,051 in bad debts was paid off at closing than funds provided by the borrower so gift funds were partly used to pay off bad debts.

The underwriter (#V175) did not explain how the borrower would be expected to make the higher mortgage payments as the buy down period expired.

The mortgage credit ratios calculated by the underwriter exceeded HUD's guidelines and no compensating factors were provided.

The underwriter used a \$325 per month child support income, but Decatur did not provide documentation showing that the payments were being received and were expected to continue.

Decatur did not document any investigation into various credit inquiries reported on the credit report.

Decatur did not document the timing of the gift wire transfer of \$7,407 from the Housing Action Resource Trust and the contribution by the seller back to the Trust of \$8,357. The gift funds were actually received first.

This loan defaulted after only five payments were received, but Decatur's management did not identify this loan as an early default and perform a quality control review.

FHA Case Number: 151-6396198

Mortgage Amount: \$ 132,559

Section of Housing Act: 203(b)

Date of Loan Closing: 09/24/01

Current Status: Delinquent but reinstated (as of 7/30/04).

Prior Status: In Default

Payments Before First Default Reported: 13

Unpaid Principal Balance: \$128,619

Summary:

Decatur Mortgage did not document the timing of the \$4,041 wire transfer gift from a non-profit donor, Nehemiah, or the \$4,841 wire transfer of the seller's contribution back to the donor. The gift actually was transferred first.

Decatur did not adequately show that the borrower established good credit since a Chapter 13 Bankruptcy discharge in 1999. The borrower had a judgment satisfied in February 2001 and had three delinquent accounts. Credit reports showed the borrower just under his credit limits; however, Decatur did not show the borrower had improved his use of credit and his attitude towards debt. The bank statements in Decatur's file do not show an ability to save.

Decatur did not verify the actual source of funds for the earnest money deposits totaling \$1,125. According to documents in Decatur's file, the initial earnest money check of \$500 was replaced by a money order but Decatur did not document the source of those funds. Bank statements showed only a \$38 balance.

Decatur did not adequately verify rental income from the borrower's prior residence to justify lowering the debts in the income sufficiency analysis. Decatur obtained a lease from the borrower dated the same day as the sales agreement showing rental income of \$414 per month. Decatur did not provide any documentation showing that any of the rent payments required by the lease were actually received by the borrower. The bank statements did not show deposits of the rent receipts. The borrower told us that Decatur had him get his sister (who was living in the former residence without a lease) to sign a formal lease agreement, but that Decatur never required him to provide evidence that he was actually receiving the rental payments.

The underwriter (#3248) calculated mortgage credit analysis ratios that exceeded HUD's guidelines, but did not provide compensating factors.

Decatur did not document any investigation of two credit inquiries identified on the credit reports.

The Appraiser (JWM17R) stated that sales in the area occurred within three months, but no explanation was provided to justify why two comparable properties were sold eight months and 11 months prior to the appraisal. The other two appraisals were FHA insured properties from the Appraiser's own files. Three of the four properties used were in the subject property's subdivision and may have been built by the same builder/seller as the subject property.

FHA Case Number: 151-6907158

Mortgage Amount: \$ 117,080

Section of Housing Act: 203(b)

Date of Loan Closing: 09/27/02

Current Status: Delinquent (as of 7/30/04) – Loan modification claim of \$750.00 paid by HUD on 5/2/04.

Prior Status: Not Applicable

Payments Before First Default Reported: 12

Unpaid Principal Balance: \$123,113

Summary:

The Appraiser (PWE2TC) used two comparable properties within six blocks in the same subdivision as the subject property that may have been built by the same builder/seller. The other two comparable properties used were over a mile from the subject property. The Appraiser stated that supply and demand were in balance, but lacked current sales in the area.

Decatur did not verify the source of the \$1,190 earnest money deposit. Bank statements did not show the borrower provided the money and the statements do not indicate an ability to save. The borrower told us that she provided a \$500 earnest money check, which was given back, and of the \$800 she gave at closing, she received \$746 back.

Decatur did not document the timing of the \$3,569 gift wire transferred from a non-profit donor, Nehemiah, or the \$4,069 in seller contribution wire transferred to the donor. The gift actually occurred first.

The underwriter (ZLPR Loan Prospector) computed mortgage analysis ratios exceeding HUD's guidelines, but did not provide adequate compensating factors. The underwriter also did not explain how the borrower would not adversely be affected as the buy down period expired.

Decatur and the underwriter used an unrealistically low figure of \$90 per month for property taxes based on unimproved land. The County provided us with the actual taxes assessed to the borrower of \$1,689 or approximately \$141 per month.

Decatur did not show that the borrower established good credit. The borrower owed \$18,830 in debts. The credit reports showed three delinquent accounts.

Decatur did not document investigation of three credit inquiries shown on the credit report.

FHA Case Number: 151-6957663

Mortgage Amount: \$ 127,585

Section of Housing Act: 203(b)

Date of Loan Closing: 11/27/02

Current Status: In Default (as of 7/30/04).

Prior Status: In Default

Payments Before First Default Reported: 5

Unpaid Principal Balance: \$126,400

Summary:

Decatur Mortgage did not document that the borrower actually provided the \$500 earnest money deposit.

Decatur did not adequately show that the borrower was an acceptable credit risk. The credit reports identified \$2,574 in delinquent borrower debt that was paid off at closing from borrower proceeds. One of the borrower's explanations for delinquent accounts was that his wife didn't pay them and didn't tell him (not a circumstance out of the borrower's control).

Decatur did not document the timing of the \$3,889 wire transfer gift from a non-profit donor (Nehemiah) and the seller contribution of \$4,389 wire transferred back to the donor. The gift actually was sent first.

Decatur did not document any investigation of a credit inquiry reported on the credit report.

This loan defaulted after only five payments had been received but Decatur's Management did not document a Quality Control Review being done for this loan as required.

The underwriter (W430) did not show how the borrower would not adversely be affected as the buy-down period expired.

FHA Case Number: 151-6610262

Mortgage Amount: \$ 153,772

Section of Housing Act: 203(b)

Date of Loan Closing: 12/31/01

Current Status: Default (as of 7/30/04)

Prior Status: Not Applicable

Payments Before First Default Reported: 15

Unpaid Principal Balance: \$149,094

Summary:

Decatur Mortgage did not document the actual provision of the \$1,562 earnest money deposit. The borrower's only investment was the \$1,562 indicated on the settlement statement. At closing the settlement agent paid \$6,009 in settlement proceeds, which exceeded the borrowers' investment by \$4,447. The excess debt payment was covered out of the \$10,687 gift from the non-profit donor.

Decatur did not document the timing of the \$10,687 gift wire transferred from the Housing Action Resource Trust or the \$11,637 seller contribution wire transferred back to the Trust. The gift was actually wire transferred first. The seller added the amount of the contribution to the non-profit donor into the calculation of the sales price according to documents in Decatur's file.

Decatur and the underwriter (AF58) used an unreasonably low estimate of property taxes in the mortgage credit analysis to qualify the borrower. The underwriter estimated \$40 per month. The County Treasurer actually assessed \$1,874 against the property, or approximately \$156 per month.

Decatur did not document any investigation of a credit inquiry shown on the credit report.

Decatur and the underwriter did not show how the borrower would not be adversely affected as the buy down period expired.

Decatur did not show how the borrowers were acceptable credit risks. The co-borrower had a Chapter 13 Bankruptcy discharged in April 1998. The credit report showed a delinquent \$12 medical bill. Gift funds from a non-profit donor were used to pay off a mobile home mortgage and an IRS lien at closing. Bank statements do not show a pattern of savings. The Appraiser (VIDEWC) used two out of three comparable properties from the subject property's subdivision, which may have been built and sold by the same builder/seller.

HUD's file contained two sales agreements with the same date. The higher sales amount was used and included a higher gift figure from the non-profit donor. The higher price covered the extra contribution to the non-profit donor that the seller would have to make.

FHA Case Number: 151-6442972

Mortgage Amount: \$ 144,637

Section of Housing Act: 203(b)

Date of Loan Closing: 09/24/01

Current Status: Default (as of 7/3004) – First legal action to start foreclosure 9/1/03

Prior Status: Not applicable

Payments Before First Default Reported: 17

Unpaid Paid Balance: \$142,694

Loss on Property Sale:

Summary:

Decatur Mortgage did not document the timing of the \$4,409 wire transfers from the non-profit donor (Nehemiah) and the wire transfer of \$5,209 from the seller's proceeds back to the donor. The gift was actually transferred first.

Decatur did not show how the borrowers were acceptable credit risks. The credit report showed 11 debts transferred to collection agencies, and five judgments. The borrower paid off two judgments before closing but Decatur did not document how they were paid. Two of the delinquent accounts were paid off at closing. Bank statements do not show a pattern of saving. Decatur did not show how the borrowers improved their attitude towards debt but merely paid off delinquent accounts.

Decatur and the underwriter (V175) did not show how the borrowers would not be adversely affected as the buy down period expired.

Decatur and the underwriter used an unreasonably low estimate of property taxes for mortgage credit analysis. The underwriter estimated \$40 per month for taxes. The actual taxes assessed by the County Treasurer were \$3,120, or approximately \$260 per month.

Three of the five comparable properties were not sold within six months of the appraisal and the Appraiser did not adequately justify that. The Appraiser (JWM17R) did not adequately justify using two comparable properties that were over a mile from the subject property.

FHA Case Number: 151-6561313

Mortgage Amount: \$ 154,686

Section of Housing Act: 203(b)

Date of Loan Closing: 01/30/02

Current Status: Delinquent (as of 7/30/04) Reinstated 2/1/04
HUD paid a Loan Modification Claim of \$650 on 4/22/04.

Payments Before First Default Reported: 11

Unpaid Principal Balance: \$153,475

Summary:

Decatur Mortgage did not document the timing of the wire transfer of the \$9,214 gift from the Housing Action Resource Trust to the settlement agent, and the seller contribution wire transferred back to the Trust. The gift was actually transferred first.

Decatur did not adequately support the earnest money deposit of \$1,523. The borrower's bank statements showed the earnest money checks being cashed but showed large unexplained deposits to the account just before the checks were issued. The bank statements did not show a pattern of savings.

The underwriter (Y471) did not adequately consider the borrowers' credit worthiness. The borrower was discharged from Chapter 7 Bankruptcy in February 1996. The credit report showed judgments and collection accounts since the bankruptcy.

According to the HUD-1 Settlement Statement, the borrowers paid \$1,523 as earnest money and gave another \$749 at closing—for a total investment of \$2,272. The settlement agent paid a total of \$5,891 out of closing proceeds to pay off the borrowers' delinquent accounts. The non-profit donor paid this negative investment of the borrower out of the \$9,214 gift.

Decatur and the underwriter improperly grossed up monthly child support payments and thereby overstated the borrowers' income. To support the child support income, Decatur obtained a copy of a court order and a child support payment history, but these documents were faxed to Decatur from one of the seller's development sales offices, instead of from the borrower and/or court.

The underwriter did not show how the borrowers would not be adversely affected as the buy-down period expired.

Decatur and the underwriter used an unreasonably low estimate of property taxes in the mortgage credit analysis. The underwriter used an estimate of \$25 per month for property taxes based on undeveloped land. Marion County actually assessed \$1,878 in taxes on the subject property, or about \$156 per month.

The Appraisal (by JWM17R) used one comparable property that was over a mile from the subject property, and two of the comparable properties were over six months before the appraisal.

In addition, Decatur's loan file contained two appraisal reports. The first—dated January 7, 2002—showed a sales price of \$152,349 and an appraised value of \$153,000. The second appraisal report was amended January 8, 2002 to show a revised sale price of \$157,141. The revised appraisal report used the same comparable properties but the comparables were adjusted upwards to a new appraised value of \$157,500.

Decatur did not document any investigation of credit inquiries that were reported on the credit reports.

FHA Case Number: 151-6485246

Mortgage Amount: \$ 150,727

Section of Housing Act: 203(b)

Date of Loan Closing: 11/19/01

Current Status: Foreclosure completed 6/1/04 (as of 7/30/04).

Payments Before First Default Reported: 7

Unpaid Principal Balance: \$149,055

Summary:

Decatur Mortgage's loan file contained a worksheet showing how the builder/seller added the anticipated gift from the non-profit donor [\$6,393] and the seller fee [\$950] (the seller pays the total amount to the non-profit donor as a contribution) into the computation of the sales price of the house. The seller modified the sales agreement with the buyer from a price of \$151,091 to \$153,116, to cover an increase of costs relating to switching from one non-profit donor to another.

On the date of closing, Decatur requested the Appraiser to change the appraisal due to the increased sales price. The Appraiser (JWM17R) revised the reports estimated value from \$152,000 up to \$153,500, which covered the revised sales price.

Decatur did not document the timing of the wire transfers of the gift from the Housing Action Resource Trust (\$6,393) and the seller contribution (\$7,343) back to the Trust. The gift was actually wire transferred first.

Decatur did not adequately verify the source of the borrower's earnest money deposit. The seller provided receipts showing three money orders of \$500 each, and a check for \$1,000 for earnest money. The bank statements showed the check for \$1,000 being cashed but did not show withdrawals corresponding to the money order purchases. Decatur did not document how the money orders were obtained. The borrower's bank statements showed very little cash and low average balances. Decatur did not investigate the large deposit to the account just prior to the \$1,000 check being issued. A sneak preview loan application in Decatur's file indicated that source of funds for the earnest money would be a "loan from Manager."

According to the HUD-1 Settlement Statement, the borrowers provided earnest money of \$1,500 but received \$195 back at closing—for a net investment of \$1,305. The underwriter (V175) had cited as a condition of approval that there be no cash out by the borrowers. The settlement agent paid \$2,378 at closing to pay off four of the borrower's delinquent accounts. This negative investment of the borrower of \$1,073 to pay off the borrower's delinquent accounts was paid from the \$6,393 gift from the non-profit donor.

Decatur did not show how the borrower's attitude towards credit made them an acceptable risk. The credit reports showed a history of bad debts, but these were only addressed by paying them off at closing.

The underwriter (V175) improperly grossed up Supplemental Social Security income and overstated this income by \$119 per month. Decatur did not establish that this income would continue for at least three years as conditioned by the underwriter.

Decatur obtained the verification documents for the Social Security benefits from the seller. Decatur also allowed the seller to provide a letter from the servicer of four student loans confirming that the loans were in forbearance.

Decatur did not obtain evidence that the borrowers were actually receiving rent payments from their prior residence (a mobile home) as indicated by a lease in HUD's loan file. The underwriter did not include the mobile home mortgage payment of \$349 per month as a liability in the mortgage credit analysis. The person who signed the lease told us that she never moved into the mobile home owned by the borrowers, and never made any lease payments to the borrowers.

Decatur and the underwriter used an unreasonably low estimate of property taxes in the mortgage credit analysis. The underwriter used \$25 per month for taxes. Marion County actually assessed taxes on the property as a completed home that amounted to approximately \$167 per month.

The underwriter computed a Total Fixed Payment to Income Ratio of 45.7 percent, which exceeded HUD's guideline. The underwriter did not provide compensating factors.

The underwriter did not show how the borrower would not adversely be affected as the buy-down period expired.

FHA Case Number: 151-6510827

Mortgage Amount: \$ 158,796

Section of Housing Act: 203(b)

Date of Loan Closing: 10/16/01

Current Status: In Default – Foreclosure started 7/1/04 (as of 7/30/04).

Payments Before First Default Reported: 16

Unpaid Principal Balance: \$154,467

Summary:

Decatur Mortgage's loan file showed a receipt from the seller that the borrower provided a \$10,000 check as earnest money deposit, but the HUD-1 does not give the borrower credit for this deposit and reduce the mortgage. Receipts and check copies show that the borrowers gave \$500 on September 15, 2001, and another \$10,000 on September 20, 2001. On September 19, 2001, the borrower's Mother-in-Law provided a \$20,000 gift in the form of a Cashier's Check. A bank verification showed that after the gift was deposited, the borrowers had a cash balance of about \$21,541 after the gift was deposited. Bank statements in Decatur's file did not show a pattern of savings or show the earnest money deposits being withdrawn. The HUD-1 showed the borrowers bringing \$15,260 to closing. The borrower told us that he provided the \$10,000 to the seller but never received credit for the deposit.

Decatur did not establish that the borrowers improved their attitude towards credit and were acceptable credit risks. The credit report identified 19 delinquent loans and accounts in collection. At closing, the settlement agent paid \$5,074 to pay off borrower bad debts.

Decatur and the underwriter (H527) used an unreasonably low estimate of property taxes in the mortgage credit analysis. The underwriter used \$25 per month for taxes as provided by Decatur but was based on the taxes for undeveloped land. The actual taxes assessed on the property as a completed home were \$2,307, or approximately \$192 per month.

The credit reports reported an additional Social Security number for the borrower and two additional numbers for the co-borrower. Decatur did not document any investigation into these additional Social Security numbers. The borrower said that Decatur never asked him about the Social Security numbers.

The Appraiser (JWM17R) did not adequately justify using three of four comparable properties that were over a mile from the subject property. One comparable was over three miles away and two were over five miles away. Two of the comparable properties were sold over six months prior to the subject, including the one comparable that was within a mile, without adequate explanation.

This loan was given a quality control review by Decatur's managing owner. The review did not disclose any deficiencies, and the documentation did not indicate what was done to review the loan.

FHA Case Number: 151-6531249

Mortgage Amount: \$ 126,672

Section of Housing Act: 203(b)

Date of Loan Closing: 11/30/01

Current Status: Terminated – Conveyed to HUD 12/01/03; Claim of \$133,003 Paid on 4/4/04; Additional claim of \$3,280 paid on 5/9/04.

Payments Before First Default Reported: 6

Unpaid Principal Balance: \$125,715

Loss on property resale: \$60,944

Summary:

Decatur Mortgage did not document the source of funds for the \$1,275 earnest money deposit from the borrower. Bank statements did not demonstrate an ability to save or the payment of the earnest money deposit.

According to the HUD-1 Settlement Statement, the only funds provided by the borrower was the \$1,275 earnest money deposit. At closing, the settlement agent paid a total of \$6,950 to pay off delinquent accounts of the borrower. The negative investment by the borrower of \$5,675 was paid out of the \$9,860 gift provided by the Housing Action Resource Trust, a non-profit donor. Decatur did not show how the borrower was an acceptable credit risk or had improved her attitude towards debt.

Decatur did not document any investigation of two credit inquiries that were reported on the credit report.

The underwriter (V175) did not document how the borrower would not be adversely affected as the buy down period expired.

The underwriter used about a \$500 per month higher income figure for the borrower than the amount supported by the employment verification.

Decatur did not document the timing of the \$9,860 gift wire transferred by the non-profit donor, or the \$10,810 seller contribution back to the donor. The gift was actually transferred first.

Decatur and the underwriter used an unrealistically low estimate of property taxes for mortgage credit analysis. The underwriter used \$40 per month as an estimate for property taxes but the County actually assessed approximately \$108 per month as a newly completed home.

According to a home cost itemized worksheet in Decatur's loan file, the seller added the contribution that it would have to make to the non-profit donor into the sales price of the subject property.

Although this mortgage defaulted after only six payments were made, Decatur's managing owner did not perform a quality control review of this loan.

FHA Case Number: 151-6537560

Mortgage Amount: \$ 141,288

Section of Housing Act: 203(b)

Date of Loan Closing: 10/30/01

Current Status: In Default but active. Foreclosure legal action started 3/1/03. (As of 7/30/04).

Payments Before First Default Reported: 9

Unpaid Principal Balance: \$138,530

Summary:

The Appraiser (JWM17R) used four comparable properties that were all located within 4 blocks of the subject property in the same subdivision. The seller of the subject is the builder, so the comparables were likely built and sold by the same seller. Two comparables were sold over a year before the subject. The Appraiser stated that supply and demand were in balance but lacked current sales data for the area.

Decatur did not document the source of funds for the borrower's \$2,000 earnest money deposit shown on the HUD-1 Settlement Statement. From Decatur's file, the seller gave a letter stating that \$1,000 was provided as earnest money provided as two personal checks of \$500 each. The bank statements did not cover the period the checks were provided and did not show the balances and checks being cashed. The HUD-1 showed a \$2,000 deposit. The borrower told us that she only provided \$1,000.

The HUD-1 Settlement Statement showed a \$2,000 earnest money deposit and the borrower received \$313 back at closing, leaving a net investment of \$1,687 (not considering the overstated deposit). At closing the settlement agent paid a total of \$6,209 to pay off the borrower's delinquent debts. This negative investment of \$4,522 was paid from the \$10,306 gift from the Housing Action Resource Trust, a non-profit donor.

Decatur and the underwriter did not show why the borrower was an acceptable credit risk. The credit report showed six delinquent accounts and three civil judgments. These items show a lack of money management and willingness to pay debts. The paying off of the \$6,209 in delinquent accounts by the settlement agent did not show an improvement in the borrower's attitude toward debt.

Decatur did not document the timing of the \$10,306 gift transfer from the Housing Action Resource Trust, or the \$11,256 seller contribution back to the Trust. The gift was actually transferred first.

The underwriter (Y471) did not show how the increased payments as the buy-down period expired would not adversely affect the borrower.

Decatur and the underwriter used an unrealistically low estimate for property taxes in the mortgage credit analysis. The underwriter used \$40 per month for taxes (unimproved land). The County actually assessed \$2,116 on the completed property, or about \$176 per month.

Decatur did not verify that the borrower's mother was actually paying car payments of \$151 per month for the borrower to justify omitting the car payments from the mortgage credit analysis.

FHA Case Number: 151-6550730

Mortgage Amount: \$ 133,980

Section of Housing Act: 203(b)

Date of Loan Closing: 11/15/01

Current Status: Foreclosed and conveyed to HUD on 1/1/04 – Claim paid \$142,6001 on 1/19/04; Additional claim of \$5,853 paid on 3/18/04 (as reported 7/30/04).

Payments Before First Default Reported: 7

Unpaid Principal Balance: \$132,998

Loss on resale of property: \$67,282

Summary:

Decatur Mortgage did not document the timing of the gift wire transfer of \$4,083 from the non-profit donor (Nehemiah) and the seller contribution of \$4,883 back to the donor. The gift was actually transferred first.

Decatur did not adequately document the source of the earnest money deposit. The deposit was provided by a \$500 check and an \$860 check. The bank statement shows the \$500 check cashed but not the second check. The bank statements don't show if there was adequate cash to make the second payment. No savings pattern was established. The bank statements showed a balance in July 2001 of \$57. In July the borrower had an unexplained deposit of \$6,000 and an unexplained withdrawal of \$4,831. Bank statements were not provided for the period where the earnest money was provided.

Decatur and the underwriter (AF58) did not show why the borrower was an acceptable risk. The credit reports show the borrower had past judgments and a Chapter 7 Bankruptcy in 1994. In 1995 the borrower had a judgment of \$25,200 on a mortgage. The credit report showed another judgment in 1998.

The underwriter included unconfirmed bonuses and overtime in the income for mortgage credit analysis.

Decatur and the underwriter used an unrealistically low estimate of property taxes in the mortgage credit analysis. The underwriter used \$25 per month for taxes, which approximated the taxes on the undeveloped land. The County actually assessed taxes of \$1,925 on the completed subject property, or about \$160 per month.

Decatur did not document any investigation of an additional Social Security number identified on the credit report. Decatur also did not investigate all credit inquiries reported on the credit report.

The Appraiser (JWM17R) used four comparables. All four comparables were FHA Insured sales. Three of the four comparables were within 3 blocks of the subject property and were in the same subdivision and likely built and sold by the same builder/seller as the subject. Two of the four comparables were sold over 6 months prior to the subject appraisal. The Appraiser said that supply and demand were in balance.

FHA Case Number: 151-6574687

Mortgage Amount: \$ 160,014

Section of Housing Act: 203(b)

Date of Loan Closing: 03/11/02

Current Status: Delinquent but reinstated by mortgagor 4/1/04 (as of 7/30/04)
Indemnification agreement with Sponsor, August 12, 2004 through August 12, 2009.
Partial claim of \$12,233 paid by HUD on 3/20/2004.

Prior Status: In Pre-foreclosure and under repayment.

Payments Before First Default Reported: 7

Unpaid Principal Balance: \$156,800

Summary:

Decatur Mortgage did not document the timing of the \$10,877 gift wire transferred from the Housing Action Resource Trust and the \$11,827 seller contribution sent back to the Trust. The gift was actually wire transferred first.

According to the HUD-1 Settlement Statement the borrower gave an earnest money deposit of \$1,557 and another \$259 at closing for an investment of \$1,816. At closing the settlement agent paid a total of \$6,736 to pay off nine of the borrower's delinquent debts. This negative investment of \$4,920 was paid from the \$10,877 gift from the non-profit donor.

Decatur did not document the actual provision of the \$1,557 earnest money deposit and source of the funds. Bank account documentation did not show a pattern of savings or the actual deposit. The borrower told us that Decatur never required him to document the source of the funds for the money orders he used to pay his earnest money deposit. The borrower said the deposit cash was from part of his wife's student loan.

The underwriter (AF58) did not establish how the borrower would not be adversely affected as the buy-down period expired.

Decatur and the underwriter used an unrealistically low estimate of property taxes for the mortgage credit analysis. The underwriter used \$25 per month for taxes, which approximated taxes on the undeveloped land. The County assessed taxes of \$1,323 on the completed subject property, which is about \$110 per month.

Decatur did not document investigation of credit inquiries that were reported on the credit reports.

The appraisal (by VIDEWC) used three comparable properties. Two of the comparable properties were sold more than six months before the appraisal and one of them was over a mile away from the subject property. The Appraiser said that current supply and demand were in balance but did not adequately justify the comparables used.

The borrower told us that the seller's staff told him not to apply for a mortgage with his wife due to her bad credit history, lack of a job and the impending foreclosure of their prior residence that the wife owned. The borrower said that a March 11, 2002 letter in Decatur's file about past due accounts was false and typed by Decatur's Loan Officer. The borrower said that the information was incorrect. The borrower said that he also hand carried a letter from his school to Decatur.

FHA Case Number: 151-6611721

Mortgage Amount: \$ 136,720

Section of Housing Act: 203(b)

Date of Loan Closing: 12/27/01

Current Status: In Default. Foreclosure started 4/1/04. (As of 7/30/04).

Prior Status: Reinstated by mortgagor on 2/1/03.

Payments Before First Default Reported: 7

Unpaid Principal Balance: \$133,698

Summary:

Decatur Mortgage's file contained two different sales agreements dated the same day. The sales price was dropped from \$144,861 to \$138,877 to reflect a lower gift fund requirement and less cash due from the borrower.

Decatur did not adequately document the source of funds for the \$1,000 earnest money deposit. The borrower's account history did not show that two \$500 checks were cashed, and there were no copies of cancelled checks. At the time the borrower signed the sales agreement showing a \$500 deposit, the borrower's account balance was only \$4. The bank statements did not show an ability to save.

Decatur did not show that the borrower was an acceptable credit risk. The credit reports showed nine delinquent accounts and past collections some of which ran up to the credit report date. The settlement agent paid off two delinquent accounts totaling \$356 at closing. The borrower told us that not all of her delinquent accounts were paid off at closing.

Decatur did not document the timing of the \$4,166 gift wire transfer from the non-profit donor (Nehemiah) and the seller contribution of \$4,666 sent back to the donor. The gift was actually wire transferred first.

The underwriter (V175) omitted a \$24 per month delinquent account from the mortgage credit analysis. The debt was reported as an overdue debt of \$1,922 on one credit report but as a collection account with \$0 due on another credit report.

Decatur and the underwriter used an unreasonably low estimate of property taxes in the mortgage credit analysis. The underwriter used an estimate of \$25 per month for taxes, which approximated taxes for unimproved land. The County assessed \$2,090 against the completed subject property, which was about \$175 per month.

The underwriter did not show how the borrower would not be adversely affected as the buy down period expired.

The appraisal (by JWM17R) used four comparable properties that were FHA insured loans and all were within 3 blocks of the subject property in the same subdivision. Being in the same subdivision means that the comparables were likely built by the same builder/seller as the subject property.

Decatur did not investigate two credit inquiries shown on the credit report. One of the inquiries was a company named Direct Rental. We found a judgment listed in the Lexis-Nexis system for \$5,093 by Auto Sales and Service filed on March 19, 2002. This debt was not listed as a debt on the applications or the credit report but likely existed at the time of the application and closing.

FHA Case Number: 151-6471089

Mortgage Amount: \$ 148,291

Section of Housing Act: 203(b)

Date of Loan Closing: 08/01/02

Current Status: Delinquent but reinstated by mortgagor 4/1/04. – (As of 7/30/04).
HUD paid a \$650 Loan Modification fee on 5/13/2004.

Unpaid Principal Balance: \$147,648

Summary:

According to the HUD-1 Settlement Statement, the borrower provided an earnest money deposit of \$1,439 as a total investment. The settlement agent paid a total of \$6,464 at closing to pay off the borrowers delinquent debts. This negative investment of \$5,025 was paid from the \$10,520 gift from the Housing Action Resource Trust gift.

Decatur Mortgage did not document the timing of the Housing Action Resource Trust gift wire transfer of \$10,520 and the seller's contribution of \$11,020 sent back to the Trust. The gift was actually wire transferred first.

Decatur did not adequately document that the borrower provided the \$1,439 earnest money deposit. The seller's letter to Decatur indicated that the borrower provided a check for \$500 and a check for \$939. The bank statements Decatur obtained did not cover the period of the checks to show they were ever cashed and no cancelled check was obtained. The bank statements did not show a pattern of savings.

Decatur did not show how the borrower was an acceptable credit risk. The credit reports showed two large collection accounts. The borrower's explanation was his foolishness at a young age. These debts were paid off at closing using gift funds.

The underwriter (Y471) used a higher income figure in the mortgage credit analysis than what was supported by employment documentation.

The underwriter did not show how the borrower would not be adversely affected as the buy down period expired. The underwriter stated that a second job was not used to qualify but the income was already overstated.

Decatur did not document any investigation of credit inquiries that appeared on the credit reports.

The Appraisal (by PWE2TC) used four comparable properties. Three of the comparables were over a mile away in a neighboring city. One of these three was sold over six months before the appraisal.

The Appraiser's comment was that the close comparable was the only one available from the subject's subdivision. The Appraiser estimated \$135 per month for taxes, which the underwriter used.

FHA Case Number: 151-6443404

Mortgage Amount: \$ 142,607

Section of Housing Act: 203(b)

Date of Loan Closing: 10/15/01

Current Status: In Default (as of 7/30/04) – HUD paid a Special Forbearance fee to the servicer of \$100 on 10/02/03.

Unpaid Principal Balance: \$140,652

Summary:

Decatur Mortgage did not document any investigation of two additional Social Security numbers identified for the co-borrower on the credit report.

The borrower had sufficient funds in the bank but Decatur did not document that the borrowers actually provided the \$1,439 earnest money deposit from the borrower's account and not from some other source.

Decatur did not document that the \$4,346 gift from a non-profit donor (Nehemiah) was wire transferred prior to the seller's contribution of \$5,146 being sent back to the donor. The gift was actually sent first.

The underwriter (3248) overstated the borrower's income by \$174 per month from what was confirmed. The borrower would likely still have qualified.

Decatur and the underwriter used an unreasonably low estimate of property taxes in the mortgage credit analysis. The underwriter used \$40 per month as taxes that approximated the taxes on unimproved land. The County actually assessed taxes on the completed subject property of approximately \$165 per month.

Decatur did not document any investigation of nine credit inquiries that were reported on the credit report.

FHA Case Number: 151-6838872

Mortgage Amount: \$ 167,728

Section of Housing Act: 203(B)

Date of Loan Closing: 08/30/02

Current Status: Foreclosure completed 7/1/04 – (as of 7/30/04).

Unpaid Principal Balance: \$166,549.

Summary:

Decatur Mortgage did not document the timing of the \$5,112 gift transfer from a non-profit donor (Nehemiah) and the seller contribution of \$5,612 back to the donor. The gift was actually transferred first.

Decatur did not adequately document the source of the \$1,000 earnest money deposit or the \$3,157 provided at closing. The seller provided a letter showing a \$1,000 check payment but the bank statements Decatur obtained do not show the check being cashed, and there is no copy of a cancelled check. The bank account showed no pattern of savings and would have barely had enough funds to pay the earnest money check.

Decatur did not show why the borrower was an acceptable credit risk. The credit report showed 18 accounts in collection. The credit report showed six debts that were not considered in the mortgage credit analysis or paid off at closing. The borrower's explanations of bad debts did not reflect a good attitude towards credit.

According to the HUD-1 Settlement Statement the borrower gave a \$1,000 earnest money deposit and brought another \$3,157 to closing for a total investment of \$4,157. The settlement agent paid a total of \$3,682 to pay off various delinquent accounts of the borrower. This shows that the borrower actually only gave \$475 towards the transaction and the balance was provided by the non-profit donor.

The underwriter (Y471) overstated income by \$301 per month in the mortgage credit analysis by using borrower overtime and gain sharing earnings that were not confirmed by the employer.

Decatur and the underwriter used an unreasonably low estimate of property taxes in the mortgage credit analysis. The underwriter used \$40 per month for taxes, which approximated taxes on unimproved land. The County assessor told us that so far the land had only been assessed at the developer's special rate for undeveloped land. The Assessor gave us an approximation of about \$110 per month as an estimate for the subject property based on local tax rates.

The appraisal report (by JWM17R) did not show the distance from the subject property for three of the four properties.

Decatur did not document any investigation into a second Social Security Number shown for the borrower on a credit report. The Lexis-Nexis system also showed the second number shown for the borrower.

Decatur did not document any investigation of two credit inquiries shown on the credit report.

The seller raised the sales price on a second sales agreement from \$165,300 to \$170,412. The second sales agreement showed a gift from a non-profit sponsor where the first did not.

FHA Case Number: 151-6688221

Mortgage Amount: \$ 139,156

Section of Housing Act: 203(b)

Date of Loan Closing: 05/15/02

Current Status: Delinquent. Partial reinstatement by mortgagor 7/1/04. (As of 7/30/04).

Prior Status: Not applicable

Payments Before First Default Reported: 9

Unpaid Paid Balance: \$136,446

Summary:

Decatur Mortgage did not document the timing of the \$4,240 gift wire transfer from a non-profit donor (Nehemiah) and the \$4,740 seller's contribution sent back to the donor. The gift was actually sent first.

Decatur did not adequately support the source of the earnest money deposit of \$1,413. Decatur did not have copies of cancelled checks, money orders and receipts to show that the earnest money was provided.

Decatur and the underwriter (Y471) used an unreasonably low estimate of property taxes for the mortgage credit analysis. The underwriter used \$40 per month for taxes, which approximated taxes on undeveloped land. Hendricks County had not yet assessed the subject property as a completed property. The County provided us with taxes assessed on other properties sold for more and less than the subject property so we were able to estimate a tax figure of approximately \$250 per month.

The Appraiser (JWM17R) used three of the five comparable properties were over two miles from the subject property. The other two comparable properties were within a block of the subject and were sold over six months before the appraisal. These two comparables were from information in the builder and appraiser files—were in the same subdivision as the subject—and likely were built and sold by the same builder/seller.

Appendix C

FHA Case Number: 151-6415426

Mortgage Amount: \$ 119,922

Section of Housing Act: 203(b)

Date of Loan Closing: 09/14/01

Current Status: Claim – Conveyed To HUD 8/1/03 (as of 7/30/04)
Indemnification agreement with sponsor 8/12/2004 through 8/12/2009.

Prior Status: Property Conveyed to Insurer

| | | |
|--------------|------------------|---------|
| Claims Paid: | \$129,433 | 8/31/03 |
| | <u>2,875</u> | 1/16/04 |
| Total | <u>\$132,308</u> | |

Payments Before First Default Reported: 4

Unpaid Paid Balance: \$119,542

Loss on Property Sale: \$59,696

Summary:

The appraisal (by JWM17R) cited three comparable properties that were 1.5 miles from the subject property and one was 2 blocks away in the subject's subdivision that was likely built by the same builder/seller as the subject.

Decatur did not document the source of funds for the earnest money deposit totaling \$1,218. The borrower provided two Travelers Express money orders totaling \$718 and three personal money orders totaling \$500. Decatur provided no support for the source of cash used to buy the money orders.

Decatur did not document the timing of the wire transfers of the gift funds of \$3,654 from a non-profit donor (Nehemiah) and the seller's contribution of \$4,454 back to the donor. The gift actually was transferred first.

Decatur did not establish that the borrower's income was stable. The borrower worked for three different employers in three different industries over a two-year period before the loan application.

The underwriter (Y471) approved this loan even though the Mortgage Payment to Income ratio exceeded HUD's guideline. The underwriter's comments related to holding two jobs since the end of January, the two for one buy-down, and a minimal increase in housing expense. The borrower intended on changing jobs and the underwriter qualified the borrower at the lower first

year buy-down rate. The underwriter did not adequately show how the borrower would not be adversely affected as the buy-down period expired. The former housing expense was materially more than the full mortgage payment.

The underwriter omitted auto loan debts totaling \$262 per month from the mortgage credit analysis.

Decatur and the underwriter used an unrealistically low estimate of property taxes, which approximated what would be paid on unimproved land. The underwriter used \$40 per month but the County actually assessed approximately \$128 per month on the completed property.

Decatur did not show that the borrower's credit worthiness improved since his Chapter 7 Bankruptcy in 1996. The borrower's credit report still showed eight delinquent accounts.

A bankruptcy discharge notice and a customer ledger from a creditor were faxed to Decatur from the seller's development sales office, demonstrating that an interested third party provided them.

Decatur's Management did not perform a Quality Control Review of this loan even though it defaulted after only 4 payments.

FHA Case Number: 151-6649076

Mortgage Amount: \$ 164,886

Section of Housing Act: 203(b)

Date of Loan Closing: 04/24/02

Current Status: Foreclosure started 4/1/04 (as of 7/30/04)

Prior Status: Default

\$100 Special Forbearance claim paid by HUD 5/22/03

.750 Loan Modification claim paid by HUD 11/9.03

\$850 Total partial claims paid

Payments Before First Default Reported: 17

Unpaid Paid Balance: \$171,147

Summary:

Decatur Mortgage did not document the timing of the wire transfers of the gift funds of \$11,025 from the Housing Action Resource Trust and the seller's contribution of \$11,525 back to the Trust. The gift actually was transferred first.

According to the HUD-1 Settlement Statement the borrower provided \$4,400 as earnest money as the only investment. At closing the settlement agent paid a total of \$9,403 to pay off the borrower's delinquent accounts. This negative investment of \$5,003 was provided by the \$11,025 gift from the donor. Decatur did not establish how the borrower was an acceptable credit risk just by paying off delinquent accounts as part of the home financing transaction.

Decatur did not adequately support the source of the earnest money deposit. Receipts from the seller indicated that the borrower provided two money orders and a bank check totaling \$4,400 for the earnest money deposit. Decatur did not establish where the money came from to buy the money orders and bank check. The bank statements in the file did not show sufficient funds for these payments.

The underwriter (Y471) omitted a \$48 per month liability that was included on the credit report but was not paid off at closing.

Decatur and the underwriter used an unrealistically low estimate of property taxes, which approximated what would be expected for unimproved land. The underwriter used \$25 per month. Hendricks County had not yet assessed the subject property as a completed home with a house on the lot, but as an unimproved lot the assessed taxes were \$445, or about \$37 per month. The taxes likely increased when the county reassessed the property as a finished home.

Decatur did not document any investigation of the credit inquiries identified on the credit reports.

The sales price was increased in this case from \$164,267 to \$167,509 to cover the increase in the gift from the non-profit donor that the seller would have to contribute back to the donor.

The appraisal (by JWM17R) cited three comparable properties. One comparable was 2 miles from the subject property and the other two were within one block that were in the same subdivision, and likely built and sold by the same builder/seller as the subject property.

FHA Case Number: 151-6642980

Mortgage Amount: \$ 149,306

Section of Housing Act: 203(b)

Date of Loan Closing: 02/18/02

Current Status: In Default (as of 7/30/04)-

Prior Status: Delinquent

Payments Before First Default Reported: 14

Unpaid Paid Balance: \$147,418

Summary:

Decatur Mortgage did not document any investigation of a second Social Security Number reported for the co-borrower on the credit reports.

The borrower's monthly rent payment shown on the credit report differed from that confirmed verbally by Decatur staff. The loan officer who took the application verbally verified the borrower's prior rent payments.

Decatur did not document the timing of the wire transfers of the gift funds of \$10,551 from Housing Action Resource Trust and the seller's contribution of \$11,501 back to the Trust. The gift actually was transferred first.

According to the HUD-1 Settlement Statement the borrower provided a \$1,517 earnest money deposit as the only investment. At closing, the settlement agent paid a total of \$6,596 to pay off delinquent accounts of the borrower. This negative investment of \$5,079 was actually paid from the \$10,551 gift from the non-profit donor.

Decatur did not establish how the borrower was an acceptable risk just by paying off delinquent accounts from the property financing transaction and gift funds. The credit report identified 10 delinquencies and defaults. Decatur did not adequately show how the borrower's attitude towards debt had changed.

The seller raised the sales price of the subject property from \$149,271 to \$151,701 when the anticipated gift requirements went up.

Decatur did not adequately establish the source of funds for the \$1,517 earnest money deposit. The earnest money was provided by three money orders and Decatur did not document where the cash came from to buy the money orders.

The underwriter (AF58) omitted a \$414 per month liability from the mortgage credit analysis. Decatur had the debt paid down at closing to less than 10 months remaining payments. This monthly payment was still material enough to affect the ability to meet borrower payment obligations.

Decatur and the underwriter used an unrealistically low estimate of property taxes, which approximated that of unimproved land. The underwriter used \$25 per month for taxes. The County actually assessed taxes of about \$160 per month on the subject property as a completed home.

The underwriter did not provide adequate compensating factors to show how the borrower would not be adversely affected as the buy-down period expired. The credit analysis was done using the initial buy down payment rate.

The appraisal (by JWM17R) cited three comparable properties. All three comparable properties were located in the subject's subdivision. One comparable was a cash sale and the other two were FHA insured. Since the comparables were all in the subject's subdivision it was likely that they were all built and sold by the same builder/seller as the subject property.

FHA Case Number: 151-6589970

Mortgage Amount: \$ 167,576

Section of Housing Act: 203(b)

Date of Loan Closing: 02/22/02

Current Status: Default (as of 7/30/04) – First legal action to start foreclosure 6/1/03

Payments Before First Default Reported: 8

Unpaid Paid Balance: \$166,091

Summary:

Decatur Mortgage did not document the timing of the wire transfers of the gift funds of \$5,108 from a non-profit donor (Nehemiah) and the seller's contribution of \$5,608 back to the donor. The gift actually was transferred first.

Decatur did not adequately support the source of \$3,750 of the \$4,250 earnest money deposit. An initial deposit of \$500 was made by check and bank statements in Decatur's file showed it being cashed with just enough cash to cover the check. Decatur did not document where the remaining \$3,750 deposit came from. The bank statements did not show a pattern of savings. The borrower told us that he sold his boat to come up with the earnest money deposit but he ended up getting \$3,447 of the cash back at the closing.

Decatur did not establish that the borrowers were acceptable credit risks. The credit report showed delinquent accounts for the borrowers.

According to the HUD-1 Settlement Statement, the borrower gave earnest money of \$4,250 but received \$3,447 back at closing—leaving a net investment of \$803. At closing the settlement agent paid a total of \$3,169 to pay off the borrower's delinquent accounts. This means that the negative investment of \$2,366 was paid from the \$5,108 provided by the non-profit donor's gift.

Decatur's file contained three letters explaining account delinquencies and why the borrower's pay stub showed less than 40 hours worked. The file also had a letter from a tire company explaining the borrower's good payment history. All four of the letters were faxed to Decatur's office from the seller's subdivision sales office. The borrower told us that the letter dated February 21, 2002 explaining his short pay period was incorrect information and he was unaware of the letter. The letter said that the borrower's girlfriend's father had died so he missed some work. The borrower said that his girlfriend's father did not pass away until June of 2003. The borrower did not know who prepared the letter.

Decatur and the underwriter (AF58) used an unrealistically low estimate of property taxes for the mortgage credit analysis. The underwriter used \$40 per month, which approximated the taxes on 2004-CH-1009

undeveloped land. Johnson County actually assessed \$2,445 in taxes against the completed property, or about \$204 per month.

Decatur did not investigate credit inquiries reported on the credit reports.

The underwriter did not show how the borrower would not be adversely affected as the buy-down period expired since the borrower was qualified at the reduced rate.

The appraisal (by JWM17R) cited four comparable properties that were all in the subject property's subdivision and likely built and sold by the same builder/seller as the subject property. Two of the comparables were over six months old at the time of the appraisal, and the other two were taken from the builders and appraiser's files.

The Appraiser initially issued her report on January 30, 2002 showing a subject sales price of \$165,849 and a value of \$167,000. The Appraiser amended her report on February 20, 2002 to show a sales price of \$170,462 and a value of \$170,500. The Appraiser did not adjust any of her comparables and did not justify the amendment.

FHA Case Number: 151-6463779

Mortgage Amount: \$ 138,852

Section of Housing Act: 203(b)

Date of Loan Closing: 09/14/01

Current Status: Claim – Conveyed to HUD on 2/01/04 (as of 7/30/04).

Prior Status: Default

Payments Before First Default Reported: 9

Unpaid Paid Balance: \$135,456

Total Claim Amount Paid: \$166,284

Loss on Property Sale: \$67,530

Summary:

Decatur Mortgage did not verify the source of funds for the \$1,411 earnest money deposit. According to a letter from the seller, the borrower provided a check for \$500 and two money orders totaling \$911. Decatur did not get bank statements or other documentation to show that the check came out of the borrower's account and where the cash for the money orders came from.

Decatur did not document the timing of the \$8,231 wire transferred gift from the non-profit donor Housing Action Resource Trust and the seller's contribution of \$9,181 sent back to Trust. According to records we got from the settlement agent's bank, the settlement agent wire transferred the seller's contribution to the donor on September 14, 2001 (day of closing) but did not receive the wire transfer from the donor until September 17, 2001 (three days later). In this case, the Seller provided the gift because it paid the donor the cash prior to the gift being made.

According to the HUD-1 Settlement Statement, the borrower gave earnest money of \$1,411 but received \$351 back at closing—for a net investment of \$1,060. At closing the settlement agent paid \$4,418 to pay off the borrower's delinquent accounts. This negative investment of \$3,358 was paid from the gift funds from the non-profit donor, which were provided by the seller.

The underwriter (V175) approved this loan with a Mortgage Payment to Effective Income ratio over HUD guidelines without compensating factors.

The underwriter did not show how the borrower would not be adversely affected as the buy-down period expired.

Decatur and the underwriter used an unrealistically low estimate of property taxes for the mortgage credit analysis. The underwriter used \$40 per month, which approximated the taxes on undeveloped land. Hamilton County actually assessed taxes against the completed property of about \$86 per month.

Decatur did not show how the borrower was an acceptable credit risk. The credit reports showed that the borrower had \$4,418 in delinquent debt and had a \$1,460 judgment. Decatur did not show improved credit worthiness just by paying off delinquent accounts from closing proceeds.

Decatur did not show that the borrower had stable income. In a 2 & ½ year period, the borrower worked at five different companies in two different positions. The borrower had only worked at her current employer for 10 months prior to closing. Decatur's processor was unable to verify the income but used pay statements to calculate the income.

Decatur did not document their investigation of eight credit inquiries that were reported on the credit report.

HUD's Neighborhood Watch system showed this loan was in default after 9 payments were received. The first payment was due 11/1/01. The Sponsor did not submit this loan to HUD for endorsement until October 9, 2002. The payment history sent by the Sponsor did not show that this loan was current when it was submitted for endorsement.

The appraisal (by JWM17R) used four comparable properties. Two comparables were from the subjects' subdivision and were likely built and sold by the same builder/seller as the subject. One of these two comparables was over six months prior to the appraisal. The other two comparable properties were one mile away and 1 & ½ miles away respectively. The Appraiser stated that supply and demand were in balance but cited a lack of recent comparable sales.

FHA Case Number: 151-6476419

Mortgage Amount: \$ 167,779

Section of Housing Act: 203(b)

Date of Loan Closing: 11/19/01

Current Status: In Default. Foreclosure started 6/1/04 (as of 7/30/04) – Partial claims paid by HUD totaling \$4,034. Indemnification agreement with sponsor for period 8/12/2004 through 8/12/2009.

Prior Status: Reinstated but delinquent

Payments Before First Default Reported: 3

Unpaid Paid Balance: \$163,630

Claims Paid:

| | | |
|---------------------|----------------|---------------|
| Partial Claim | \$3,934 | paid 11/16/02 |
| Special Forbearance | <u>100</u> | paid 6/23/03 |
| Total: | <u>\$4,034</u> | |

Summary:

Decatur Mortgage did not document the timing of the \$5,179 wire transferred gift from a non-profit donor (Nehemiah) and the seller's contribution of \$5,979 sent back to the donor. The gift was actually sent first.

Decatur did not document the source and provision of \$1,500 of the \$1,726 earnest money deposit.

Decatur and the underwriter (V175) omitted a \$10 per month debt on the credit report from the mortgage credit analysis without justification. Another \$43 per month debt was deleted from a revised credit report and Decatur did not explain why this debt was omitted.

Decatur did not show how the borrower improved his attitude towards credit after a Chapter 7 Bankruptcy discharged in 1999. The credit reports reported nine small accounts with delinquencies. The settlement agent paid off \$372 of the borrower's delinquent accounts at closing.

Decatur did not document adequate investigation of eight credit inquiries reported on the credit report. The one credit inquiry that the borrower did explain was an auto inquiry. The borrower's explanation was that the auto dealer was looking for the best interest rate for a new

Chevy Lumina. This explanation indicated that the borrowers were in the process of buying a new car at the time of the loan application. No further research was indicated.

Decatur and the underwriter used an unrealistically low estimate of property taxes for the mortgage credit analysis. The underwriter used \$40 per month, which approximated the taxes on undeveloped land. The County actually assessed taxes against the completed property of about \$253 per month.

This loan went into default after only three payments were made. The loan servicer reported that the cause of the default was excessive obligations. Decatur's management did not perform a Quality Control Review of this loan.

FHA Case Number: 151-6476579

Mortgage Amount: \$ 130,935

Section of Housing Act: 203(b)

Date of Loan Closing: 11/19/01

Current Status: Claim Paid. Property conveyed to insurer 2/1/04, claim payment of \$136,315 on 2/5/04, and payment of \$5,898 on 5/9/04 (as of 7/30/04). Indemnification agreement with sponsor 8/12/2004 through 8/12/2009.

Prior Status: Per Neighborhood Watch dated 4/29/04, Foreclosure Completed

Payments Before First Default Reported: 2

Unpaid Principal Balance: \$127,563

Appraiser: Appraiser's Staff ID # JWM17R

Loss on Resale: \$64,912

Summary:

Decatur Mortgage did not document any investigation into an additional Social Security Number for the borrower shown on the Mortgage Credit Services, Incorporated credit report dated 10/17/01. Decatur did not investigate to determine whether the borrower used the number or may have co-signed loans.

The sales price increased by \$2,500 on the second purchase agreement based on the Nehemiah Gift being replaced by a Housing Action Resource Trust (Hart) Gift for \$1,795 more money.

Decatur did not adequately show that the borrower was an acceptable credit risk. The credit reports identified 14 delinquent accounts and accounts in collection, and the borrower's explanations did not adequately explain how the delinquencies were outside of his control. Decatur had the settlement agent pay off nine delinquent accounts at closing. This did not make the borrower an acceptable credit risk.

Decatur did not document the timing of the \$5,695 wire transfer gift from the Housing Action Resource Trust, and the seller contribution of \$6,645 wire transferred back to the Trust. The gift actually was sent first, but it was Decatur's responsibility to document the source of the gift funds, and they did not do this.

Decatur did not adequately document the source of funds of \$1,100 for the earnest money deposit. The bank statements did not cover the period of the indicated checks, and the source of funds for the unusual deposits was not established. The HUD-1 settlement statement only gave

the borrower credit for a \$500 earnest money deposit, and the borrower may have been overcharged by an additional \$600 in earnest money deposit.

Decatur did not document a Quality Control Review for this mortgage loan that defaulted after two payments. HUD requires a 100 percent full review of any mortgage loan that defaults in the first six months after closing.

Decatur did not properly verify the borrower's employment and pay statements, and the underwriter (AF58) overstated the borrower's monthly income by \$69 per month.

Decatur incorrectly omitted a monthly rental/purchase liability of \$115, and the underwriter understated the borrower's liabilities by \$115 per month by not including the 24-month rental agreement as a debt.

Decatur did not document an investigation on whether a \$356 per month family auto loan on the Quick Questionnaire was the same debt as the \$312 Tranex auto loan, or new debt not reported on the credit report. The underwriter may have understated the borrower's debts and mortgage credit ratios by not including the \$356 as debt.

The underwriter used an unreasonably low estimate of property taxes in the mortgage credit analysis to qualify the borrower. The underwriter estimated \$40 per month. The Marion County Treasurer actually assessed \$1,844 against the property, or approximately \$154 per month.

The appraiser (JWM17R) used two comparables in the subject property's subdivision, and two comparables over two miles from the subject property, that were over six months before the subject appraisal.

Decatur accepted a faxed rental letter, written explanation of bad debts, borrower pay statements and a W-2 form, from the seller's Sales Office at River's Edge Townhouses—an interested third-party.

FHA Case Number: 151-6477778

Mortgage Amount: \$ 128,651

Section of Housing Act: 203(b)

Date of Loan Closing: 11/07/01

Current Status: Default (as of 7/30/04).

Prior Status: Repayment

Payments Before First Default Reported: 14

Unpaid Principal Balance: \$127,080

Appraiser: Appraiser's Staff ID #JWM17R

Summary:

The Appraiser (JWM17R) used two comparables in the subject property's subdivision.

The underwriter (H527) used an unreasonably low estimate of property taxes in the mortgage credit analysis to qualify the borrower. The underwriter estimated \$25 per month. The Marion County Treasurer actually assessed \$1,383 against the property, or approximately \$115 per month.

The underwriter used an unreasonably low estimate of property taxes to reduce the mortgage credit analysis ratios and qualify the borrower. The underwriter did not provide compensating factors to justify underwriting this mortgage loan.

The underwriter did not adequately show that the borrower was an acceptable credit risk. The credit reports identified four Civil Judgments and bad debts totaling \$8,084 that were paid off at closing from Housing Action Resource Trust Gift Funds. The use of gift Funds to pay off the borrower's debts is an inducement, and reduces the selling price of the property.

Decatur did not document the timing of the \$9,922 wire transfer gift from a non-profit donor to the settlement agent, and the seller payment wire transferred back to the donor. The gift actually was sent first.

The underwriter did not document how the borrower would not be adversely affected as the buy-down period expired.

Decatur did not document the source of funds for the earnest money deposit. The bank statements do not show the funds being withdrawn from the borrower's account.

FHA Case Number: 151-6482988

Mortgage Amount: \$ 120,785

Section of Housing Act: 203(b)

Date of Loan Closing: 11/08/01

Current Status: Claim of \$125,615 paid 12/11/03. Additional claim of \$2,588 paid 4/23/04. Property conveyed to insurer (on 12/01/03). Indemnification agreement with sponsor for 8/14/2004 through 8/14/2009.

Prior Status: Foreclosure Completed 10/01/03

Payments Before First Default Reported: 4

Unpaid Principal Balance: \$119,742

Appraiser: Appraiser's Staff ID #JWM17R

Loss on Resale: \$51,981

Summary:

Decatur Mortgage did not document the source of funds of \$1,250 for the earnest money deposits that was paid for with money orders. The bank statements did not cover the period when the earnest money payments were made to the seller, and no ability to save was established. No evidence was provided to show the actual source of the cash used to buy the money orders, and the previous months bank balance was \$11 as of July 31, 2001.

Decatur did not document the timing of the Housing Action Resource Trust (Hart) Gift wire-transferred from the non-profit donor to the settlement agent, or the seller contribution wire-transferred back to the donor. Decatur did not document that the gift funds came from the donor's funds and not the sellers. The gift was actually wire transferred first.

The underwriter (AF58) used an unreasonably low \$25 per month estimate of property taxes in the mortgage credit analysis to qualify the borrower. The County Treasurer actually assessed \$1,215 against the property, or approximately \$101 per month.

Decatur did not document any investigation of a credit inquiry shown on the credit report to ensure that the borrower did not obtain any additional credit.

The underwriter did not show how the borrower would not be adversely affected as the two year buy-down period expired.

The underwriter did not use an estimate for homeownership association dues in the mortgage credit analysis. This understated housing expenses by \$20.33 per month.

The underwriter would have exceeded HUD's mortgage credit ratios, and this would have required compensating factors for loan approval, if the underwriter considered the full principal and interest amount of the note, the association dues, and property taxes assessed.

The underwriter overestimated the borrower's monthly income by \$425 per month on the mortgage credit analysis.

Decatur accepted faxed pay statements from the seller's sales office. The employment documentation cannot be handled by an interested third party (Arlington Meadows).

The Appraiser (JWM17R) used all three comparable properties from the subject property's subdivision, which may have been built and sold by the same builder/seller.

HUD's file contained two sales agreements with different dates. The higher sales amount was used and included a higher gift figure from the non-profit donor. The higher price covered the extra contribution to the non-profit donor that the seller would have to make.

Housing Action Resource Trust Gift Funds were used to pay off the borrower's debts. According to the HUD-1 Settlement Statement, the borrower provided \$1,250 in earnest money, and another \$43 at closing, for a total investment of \$1,293. At closing the settlement agent paid \$2,079 to pay off the borrower's delinquent accounts. The negative investment of \$786 was paid out of the gift from the non-profit donor.

Decatur did not document a Quality Control Review of this mortgage loan. The mortgage loan defaulted after four payments, and HUD requires all mortgage loans that default within the first six months after closing to undergo a 100 percent review.

FHA Case Number: 151-6483461

Mortgage Amount: \$ 165,800

Section of Housing Act: 203(b)

Date of Loan Closing: 12/03/01

Current Status: Foreclosed and conveyed to HUD on 6/1/04. HUD paid claim of \$174,454 on 6/24/04. (As of 7/30/04)

Prior Status: Foreclosure Started on 6/01/03

Payments Before First Default Reported: 13

Unpaid Paid Balance: \$161,419

Loss on Property Sale: N/A

Appraiser: Appraiser's Staff ID #JWM17R

Summary:

Decatur Mortgage did not document an investigation of an additional social security number for the borrower on the credit report.

Decatur did not document the timing of the wire transfers of \$10,552 from the non-profit donor (Housing Action Resource Trust) to the settlement agent, and the wire transfer of the seller's contribution of the Gift, plus a fee from the seller's proceeds back to the donor. The Gift was actually transferred first.

Decatur did not show how the borrowers were acceptable credit risks. The credit report showed 20 delinquencies in excess of \$5,000, and one Municipal Court Judgment that was not satisfied. Decatur did not demonstrate how the borrowers improved their attitude toward debt by paying off the borrower's delinquent accounts at closing by proceeds from the non-profit donor and the borrower.

The underwriter (AF58) used an unreasonably low estimate of property taxes to qualify the borrower for the mortgage credit analysis. The underwriter estimated \$25 per month for taxes. The actual taxes assessed by the County Treasurer were \$2,436, or approximately \$203 per month.

The underwriter did not document how the borrower would be able to afford the increase in property taxes as of the first escrow analysis.

Decatur did not document the Omission of Liabilities in excess of \$5,000 obtained from the credit report, and excluded from the initial and final Uniform Residential Loan Application.

The underwriter did not provide compensating factors to justify approving this loan, which exceeded HUD's approved maximum ratios.

Two of the four comparable properties are over one mile from the subject property, and the Appraiser (JWM17R) did not adequately justify using these properties.

According to the HUD-1 Settlement Statement, the borrower gave a \$1,701 earnest money deposit and \$49 at closing—for a total investment of \$1,750. At closing, the settlement agent paid a total of \$5,814 to pay off the borrower's delinquent accounts. The Housing Action Resource Trust (a non-profit donor) provided the negative investment of \$4,064.

FHA Case Number: 151-6486054

Mortgage Amount: \$ 143,115

Section of Housing Act: 203(b)

Date of Loan Closing: 11/21/01

Current Status: In Default. (as of 7/30/04)

HUD Paid \$750 loan modification fee on 9/14/2003.

Indemnification agreement with sponsor for 8/12/2004 through 8/12/2009.

Prior Status: Forbearance (on 3/01/04).

Payments Before First Default Reported: 2

Unpaid Principal Balance: \$160,622

Appraiser: Appraiser's Staff ID #JWM17R .

Summary:

Decatur Mortgage did not document the timing of the \$6,562 Housing Action Resource Trust Gift wire-transfer, and the seller contribution of \$7,512 wire transfer back to the Trust. The gift actually was sent first.

According to the HUD-1 Settlement Statement, the borrower provided \$1,443 in earnest money, plus \$23 at closing, for a total investment of \$1,466. The settlement agent paid \$3,094 at closing to pay off the borrower's delinquent accounts. This negative investment of \$1,628 was paid from the \$6,562 gift from the non-profit donor, Housing Action Resource Trust.

Decatur did not provide documentation to show the borrowers provided the source of funds for the earnest money deposit. Bank account information did not show the payment and did not show a history of savings.

The underwriter (AF58) did not adequately consider the borrowers credit worthiness after their Chapter 7 Bankruptcy. The closing agent paid off 11 collection and delinquency accounts, and the underwriter did not establish how the borrowers attitude and use of credit had improved.

The underwriter did not establish how the borrower would not adversely be financially affected as the buy-down period expired.

Decatur and the underwriter used an unrealistically low estimate of property taxes for the mortgage credit analysis. The underwriter used \$40 per month for taxes, which approximated taxes on unimproved land. The County actually assessed \$1,426 on the property as a completed residence that approximated \$119 per month.

Decatur did not investigate and resolve a second Social Security Number for the co-borrower that was reported in the credit report.

Decatur did not establish that the borrower had stable income. The borrower held more than 4 unrelated jobs in the last two years, for brief periods

Decatur did not document a quality control review of this case file. This mortgage loan defaulted after two payments, and HUD requires a 100 percent review of early payment loan defaults.

The seller raised the sales price of the house on a second sales agreement from \$143,459 to \$145,392 when the non-profit donor was changed from Nehemiah to the Housing Action Resource Trust program.

The Appraiser (JWM17R) issued the appraisal report on October 25, 2001 with an estimated value of \$144,000. The Appraiser modified the appraisal on November 26, 2001 (after closing) giving a new estimate of \$145,500. The Appraiser adjusted each comparable property up by \$1,000 each and the revised value covered the revised sales price of the property.

FHA Case Number: 151-6486185

Mortgage Amount: \$ 110,229

Section of Housing Act: 203(b)

Date of Loan Closing: 09/19/01

Current Status: Property conveyed to insurer (on 9/01/03)
Indemnification agreement with sponsor for 8/12/2004 through 8/12/2009.

Claim: \$116,976 claim paid on 9/08/03 and \$2,079 claim paid 12/27/03.

Prior Status: Foreclosure completed on 4/1/03 per Neighborhood Watch 5/06/04.

Payments Before First Default Reported: 5

Unpaid Principal Balance: \$109,702

Appraiser: Appraiser's Staff ID #JWM17R.

Loss on Resale: \$56,963

Summary:

The underwriter (3248) used an unreasonably low property tax figure of \$40 per month to analyze the borrowers ability to pay the mortgage. The actual taxes assessed amounted to \$77 per month.

The underwriter computed a Mortgage Payment to Income Ratio of 32 percent on the Mortgage Credit Analysis Worksheet. This exceeded HUD's ceiling of 29 percent, and required compensating factors. The underwriter did not provide adequate compensating factors to justify approving this loan

The borrower defaulted after five payments, and HUD requires a 100 percent Quality Control Review. Decatur Mortgage did not document a review was performed on this early payment defaulted mortgage loan.

The underwriter did not show how the borrower would not adversely be financially affected as the buy-down period expired.

Decatur did not establish that the borrower had stable employment. The borrower was showing 10 months full time employment, and the borrower continually changed part time jobs.

Decatur did not document the timing of the \$3,360 Nehemiah Gift wire-transfer to the settlement agent, and the seller contribution of \$4,160 back to the non-profit donor. The gift funds were actually sent first.

FHA Case Number: 151-6490797

Mortgage Amount: \$ 111,954

Section of Housing Act: 203(b)

Date of Loan Closing: 09/21/01

Current Status: In Default (as of 7/30/04). Foreclosure Started (on 2/01/04)

Prior Status: Delinquent as of 8/01/03.

Payments Before First Default Reported: 19

Unpaid Principal Balance: \$109,934

Appraiser: Appraiser's Staff ID #JWM17R

Summary:

The underwriter (ZLPR Loan Prospector) did not document how the borrower would not adversely be financially affected as the buy-down period expired.

The underwriter used an unreasonably low property tax figure of \$40 per month to analyze the borrowers ability to pay the mortgage. The actual taxes assessed amounted to \$72.68 per month.

The underwriter computed a Total Fixed Payment to Income Ratio of 55 percent on the Mortgage Credit Analysis Worksheet. This exceeded HUD's ceiling of 41 percent, and required compensating factors. The underwriter did not provide adequate compensating factors to justify approving this loan.

Decatur Mortgage did not document the timing of the \$3,413 Nehemiah Gift wire-transfer to the settlement agent, and the seller contribution of \$4,213 (included the fee), wire-transfer back to the donor. The gift funds were sent first.

All three of the comparable properties were within two blocks of the subject property, and possibly in the same subdivision. Comparables 2 & 3 were sold more than six months before the subject appraisal. The Appraiser (JWM17R) did not adequately justify using these properties.

FHA Case Number: 151-6494487

Mortgage Amount: \$ 105,864

Section of Housing Act: 203(b)

Date of Loan Closing: 11/28/01

Current Status: Default (as of 7/30/04). First legal action to commence foreclosure on 3/01/04.

Prior Status: Foreclosure Started on 3/01/03.

Payments Before First Default Reported: 10

Unpaid Principal Balance: \$104,680

Appraiser: Appraiser's Staff ID #JWM17R

Summary:

The underwriter (Y471) used an unreasonably low property tax figure of \$25 per month to analyze the borrowers ability to pay the mortgage. The actual taxes assessed on the completed residence amounted to \$141 per month.

Decatur Mortgage did not document and verify the \$334 car payment listed on the pre-loan application. The exclusion on the Uniform Residential Loan Application is an Omission of Liabilities, and the exclusion of the car debt on the Mortgage Credit Analysis Worksheet reduced the borrowers recurring expenses and ratios.

Comparables 3 & 4 were within two blocks of the subject property, possibly in the same subdivision, and their sales dates were over six months from the appraisal date. Comparables 1 & 2 were located more than two miles from the subject property, and the appraiser (JWM17R) did not adequately justify using these properties.

FHA Case Number: 151-6507102

Mortgage Amount: \$ 132,660

Section of Housing Act: 203(b)

Date of Loan Closing: 10/31/01

Current Status: Property Conveyed to HUD on 4/01/04.

Prior Status: Foreclosure Completed on 2/01/04.

Claim: \$138,025 Date Paid: 4/09/04

Payments Before First Default Reported: 15

Unpaid Principal Balance: \$129,391

Appraiser: Appraiser's Staff ID #VIDEWC

Loss on Resale: \$58,437

Summary:

The underwriter (AF58) did not document how the borrower would not adversely be financially affected as the buy-down period expired.

The underwriter used an unreasonably low property tax figure of \$40 per month to analyze the borrowers ability to pay the mortgage. The actual taxes assessed amounted to \$228 per month.

Decatur Mortgage did not document and verify, per the credit report, the two names using the borrower's social security number, and two different social security numbers for the co-borrower, and how these problems were resolved.

Decatur did not document the timing of the \$10,042 Housing Action Resource Trust Gift wire-transfer to the settlement agent, and the seller contribution of \$10,992 (includes the fee) wire-transfer back to the Trust. The gift funds were actually sent first.

All three of the comparable properties were within five blocks of the subject property, and were in the same subdivision and likely built and sold by the same builder/seller as the subject property. Comparable 1 was sold more than six months before the subject property appraisal on 10/26/01, and the Appraiser (VIDEWC) did not adequately justify using this property.

Decatur allowed an interested third party to provide some of the documentation for loan processing. Earnings statements, social security benefits, various debt, and deposit explanation letters were faxed from a project named Rivers Edge. Rivers Edge is one of the Builder/Seller's developments.

The Housing Action Resource Trust Gift Funds were used to pay off \$6,087 of the borrower's debts at closing, per the debts listed on the credit report. The HUD-1 Settlement Statement shows the borrower giving a \$1,300 earnest money deposit but getting back \$505 at closing for a net investment of \$795. At closing, the settlement agent paid \$6,087 to pay off the borrower's delinquent accounts. This negative investment of \$5,292 was paid from the \$10,042 gift from the Housing Action Resource Trust (non-profit donor).

FHA Case Number: 151-6527323

Mortgage Amount: \$ 134,842

Section of Housing Act: 203(b)

Date of Loan Closing: 11/05/01

Current Status: Property Conveyed to HUD on 9/01/03.

Prior Status: Foreclosure Completed on 2/01/03.

Claim: \$144,970 Date Paid: 9/25/03

Payments Before First Default Reported: N/A

Unpaid Principal Balance: \$132,490

Appraiser: Appraiser's Staff ID #JWM17R .

Loss on Resale: \$70,131

Summary:

The underwriter (Y471) did not document how the borrowers would not adversely be financially affected as the buy-down period expired.

The underwriter used an unreasonably low property tax figure of \$40 per month to analyze the borrowers ability to pay the mortgage. The actual taxes assessed amounted to \$118 per month.

Decatur Mortgage did not document and verify, per the credit report, the five inquiries within 90 days (one was a collection inquiry). There was no information in the file to determine if the loan processor followed up or investigated the credit inquiries.

Decatur did not document the timing of the \$10,110 Housing Action Resource Trust Gift wire-transfer to the settlement agent, and the seller contribution of \$11,069 (includes the fee) wire-transfer back to the donor. The gift funds were sent first—in the proper order.

Decatur did not establish that the borrowers had stable employment. The borrowers worked for two different employers in two different industries over a one-year period leading up to the mortgage application.

Decatur did not verify the source of funds for the earnest money deposit, which totaled \$1,377 over four payments, according to a letter in the file from Dura Builders to Decatur Mortgage. Bank statements were not verified during this time period, and there was little evidence in the files to verify that the borrower made the earnest money deposit.

Comparables 1 & 4 were within one block of the subject property, and possibly in the same subdivision. Comparables 2 & 3 were more than one mile from the subject property, and the Appraiser (JWM17R) did not adequately justify using these two comparables when comparables are located more than one mile from the subject property. All four comparable properties were FHA insured and three were from the builder and appraiser's files.

The underwriter did not establish that the borrowers had established good credit. The credit report showed three Civil Judgments, a tax lien, and over \$3,000 in past due debts.

According to the HUD-1 Settlement Statement, the borrower provided \$1,377 in earnest money, plus \$202 at closing, for a total investment of \$1,579. At closing, the settlement agent paid a total of \$7,265 to pay off the borrower's delinquent accounts. Housing Action Resource Trust Gift Funds of \$10,110 provided this negative investment of \$5,686.

The borrowers went into default after only making three payments, and Decatur's managing owner provided insufficient documentation to determine what work was done in the Quality Control Review they completed. The managing owner found no deficiencies in their review.

FHA Case Number: 151-6542156

Mortgage Amount: \$ 153,924

Section of Housing Act: 203(b)

Date of Loan Closing: 11/05/01

Current Status: In Default as of 7/30/04. Foreclosure Started on 11/01/02.

Prior Status: Delinquent on 10/01/02.

Payments Before First Default Reported: 4

Unpaid Principal Balance: \$148,346

Appraiser: Appraiser's Staff ID #VIDEWC

Summary:

The underwriter (3248) did not document how the borrowers would not adversely be financially affected as the buy-down period expired.

The underwriter used an unreasonably low property tax figure of \$40 per month to analyze the borrowers ability to pay the mortgage. The actual taxes assessed amounted to \$124 per month.

Decatur Mortgage did not document the timing of the \$10,691 Housing Action Resource Trust Gift wire-transfer to the settlement agent, and the seller contribution of \$11,641 (includes the fee) wire-transfer back to the Trust. The gift funds were actually sent first, but Decatur did not document the source of the gift as required by HUD.

The underwriter overstated the borrowers other income. The borrowers' two children were entitled to receive social security benefits until they reach age 18. The underwriter overstated the benefit (income) by 25%, and should not have used this benefit in the analysis. To count the benefit it must be scheduled to last for at least three years, and the children were to receive the benefit for less than two years. HUD does not consider it a reliable source of income unless it lasts for at least three years.

The underwriter did not verify the source of funds for the earnest money deposit totaling \$1,564 over four payments according to a letter in the file from Dura Companies to Decatur. The borrower did not have a checking or savings account, and no documentation was provided to support the source of funds for the money orders.

Comparables 1 & 3 were within five blocks of the subject property, and were in the same subdivision. They were sold more than six months before the subject property appraisal on 10/26/01. Comparable 1 is 1-1/2 miles from the subject property, and the Appraiser (VIDEWC) did not adequately justify using this one comparable.

The underwriter did not document that the borrowers had established good credit. The credit report showed three Civil Judgments, a Repossession, and nine past due debts.

According to the HUD-1 Settlement statement, the borrower provided \$1,505 in earnest money as the total investment. At closing the settlement agent paid \$4,604 to pay off the borrower's delinquent accounts. The Housing Action Resource Trust Gift Funds of \$10,691 provided this negative investment of \$3,099.

Decatur did not document and verify, per the credit report, two names using the same social security number. Decatur did not document an investigation into the second social security number.

The underwriter did not provide compensating factors to justify calculating the borrower's total mortgage payment using the first year buy-down amount for principal and interest.

FHA Case Number: 151-6567251

Mortgage Amount: \$ 151,539

Section of Housing Act: 203(b)

Date of Loan Closing: 12/31/01

Current Status: Foreclosure Completed on 5/01/03. Conveyed to HUD 7/1/04. Claim of \$162,252 paid on 7/24/04.

Prior Status: Foreclosure completed 5/1/03.

Payments Before First Default Reported: 5

Unpaid Principal Balance: \$150,940

Appraiser: Appraiser's Staff ID #VIDEWC

Summary:

Decatur Mortgage did not document the timing of the \$10,619 Housing Action Resource Trust Gift wire-transfer to the settlement agent, and the seller contribution of \$11,569 (includes the fee) wire-transfer back to the Trust. The gift funds were actually sent first, but Decatur did not document the source of the gift as required by HUD.

The underwriter (AF58) used an unreasonably low property tax figure of \$40 per month (which approximated taxes on undeveloped land) to analyze the borrowers ability to pay the mortgage. The actual taxes assessed amounted to \$180.53 per month.

The underwriter did not document how the borrowers would not adversely be financially affected as the buy-down period expired.

Decatur did not document the reasoning for the three different appraisal amounts in the mortgagee case file, and each time the appraisal amount increased. The appraisal estimated value increased when the subject's sales price increased. This showed that the Appraiser (VIDEWC) raised the property's value when the sales price increased.

Decatur did not identify this mortgage loan as an early payment default and perform a Quality Control Review as required by HUD.

The underwriter did not document whether the borrower had established good credit after a Chapter 7 Bankruptcy. The credit report showed 16 delinquent accounts subsequent to bankruptcy.

Decatur did not investigate and document possible day care expenses for the co-borrower. This recurring expense would have been included in the Mortgage Credit Analysis Worksheet, and would have affected the fixed payment-to-income ratio, and required a compensating factor.

According to the HUD-1 Settlement Statement, the borrower provided an earnest money deposit of \$1,000 and another \$156 at closing, for an investment of \$1,156. At closing, the settlement agent paid \$6,733 to pay off the borrower's delinquent accounts. This negative investment of \$5,577 was paid out of the \$10,619 gift from the non-profit donor.

FHA Case Number: 151-6584264

Mortgage Amount: \$ 156,259

Section of Housing Act: 203(b)

Date of Loan Closing: 01/08/02

Current Status: Claim of \$166,098 paid on 4/12/04 (as of 7/30/04) – Conveyed to HUD for Insurance Benefits on 4/1/04.

Prior Status: Foreclosure completed 2/01/04

Payments Before First Default Reported: 8

Unpaid Paid Balance: \$152,674

Total Claim Amount Paid: \$166,098

Loss on Property Sale: \$55,089

Summary:

Decatur Mortgage did not verify the source of the \$1,587 earnest money deposit. According to receipts from the builder/seller, the borrowers paid their earnest money deposit in two personal checks. There were copies of the uncanceled checks. The bank statements in the loan files did not show these two checks being cashed and the bank statements did not show a history of savings.

Decatur did not document the timing of the wire transfers of the \$4,763 gift from the non-profit donor (Nehemiah) and the \$5,263 seller's contribution back to the donor. The gift transfer actually occurred first.

The underwriter (V175) approved this mortgage after computing ratios that exceeded HUD guidelines. The underwriter did not provide compensating factors to justify the approval.

The underwriter omitted two liabilities as shown on the credit report from the mortgage credit analysis. The two debts were \$258 per month to Bank One, and \$152 per month owed to Wells Fargo. No debts were paid off at closing and the files did not show these debts being paid off. These two debts totaled \$410 per month.

Decatur and the underwriter used an unrealistically low estimate of property taxes in the mortgage credit analysis. The underwriter used \$40 per month, which approximated taxes on the unimproved land. Marion County actually assessed property taxes of \$1,939, or about \$161 per month as a completed residential property.

The loan officer who took the application also performed a verbal verification of rent.

The Appraiser (JWM17R) used three comparable properties. The Appraiser stated that supply and demand were in balance. Two of the comparables were 5 blocks away but both were conventional loans and the sales were over six months prior to the subject appraisal. The third comparable was an FHA insured loan that was 1.6 miles away from the subject and was derived from the builder's and Appraisers files.

In Decatur's file we noted that all of the pay statements and a bank statement were faxed to Decatur from a place named Lloyd Meadows. This may have been a subdivision owned by the seller.

We also noted that Decatur's file contained two typewritten unsigned letters. One letter explained a gap in the borrower's employment, and the other discussed delinquent accounts. Both of these letters had notes attached that said, "sign at closing." These letters appeared to have been prepared by someone other than the borrower, and Decatur was to have the letters signed by the borrower at closing.

FHA Case Number: 151-6584501

Mortgage Amount: \$ 134,893

Section of Housing Act: 203(b)

Date of Loan Closing: 02/21/02

Current Status: Claim paid. - Conveyance to HUD 10/1/03.
Indemnification agreement with sponsor for 8/12/2004 through 8/12/2009.

Prior Status: Conveyed to HUD 10/01/03

Payments Before First Default Reported: 2

Unpaid Paid Balance: \$134,583

| | |
|---------------------------------|---------------------------|
| <u>Total Claim Amount Paid:</u> | \$143,236 paid 10/25/03 |
| | <u>2,662</u> paid 2/21/04 |
| Total | <u>\$145,898</u> |

Loss on Property Sale: \$62,098

Summary:

Decatur Mortgage did not verify the source of funds for the \$1,370 earnest money deposit. Decatur did not obtain bank statements showing checks provided as earnest money were cashed. The bank statements provided showed little cash and no ability to save.

Decatur did not document the timing of the wire transfer of \$6,211 from a non-profit donor Housing Action Resource Trust and the seller's contribution of \$7,161 back to the Trust. The transfers actually took place in the proper order.

According to the HUD-1 Settlement Statement, the borrower gave earnest money of \$1,370, plus \$170 at closing, for a total investment of \$1,540. At closing, the settlement agent paid \$2,976 to pay off the borrower's delinquent accounts. This negative investment of \$1,436 was paid from the \$6,211 gift from the non-profit donor.

Decatur did not show how the borrower was an adequate credit risk. The credit report indicated eight delinquent accounts that Decatur paid off at closing out of closing proceeds. This payoff did not change the borrower's attitude towards credit.

Decatur did not investigate a credit inquiry reported on the credit report.

The underwriter (V175) approved this loan although the mortgage credit ratios exceeded HUD guidelines. The only compensating factors provided were: job stability, ratios within guidelines and a 2-for-1 buy-down. The ratios as computed were over HUD's guidelines as shown on the Mortgage Credit Analysis Worksheet using the lowest payment level under the buy-down. The underwriter's justification was inadequate.

The underwriter did not show how the borrower's ability to pay would not adversely be affected as the buy-down period expired. The borrower's ratios were already over HUD guidelines at the lowest buy-down amount.

Decatur and the underwriter used an unrealistically low estimate of property taxes for the mortgage credit analysis. The underwriter used \$25 per month for property taxes, which approximated the taxes on unimproved land. Marion County actually assessed \$1,595 against the completed home, which was about \$133 per month.

The Appraisal report (by JWM17R) used three comparable properties one mile from the subject property and one that was one block away in the same subdivision—and likely built by the same builder/seller as the subject property. All four comparable properties were FHA insured properties from the builder's and Appraiser's files.

This loan went into default after only two payments had been received. Decatur's management did not identify this loan as an early default loan, and did not perform a Quality Control Review of the loan.

FHA Case Number: 151-6588010

Mortgage Amount: \$ 116,623

Section of Housing Act: 203(b)

Date of Loan Closing: 03/11/02

Current Status: Default. First legal action to commence foreclosure on 3/1/04 (as of 7/30/04) –

Prior Status: In Default

Payments Before First Default Reported: 9

Unpaid Paid Balance: \$114,995

Summary:

Decatur Mortgage did not verify the source of funds for the \$1,113 earnest money deposit. The bank statements in the loan file did not support the provision of the deposits, and the statements did not show a pattern of savings.

Decatur did not document the timing of the wire transfers of \$4,675 from the non-profit donor Housing Action Resource Trust and a \$5,625 seller contribution back to the Trust. The gift was actually wire transferred first.

According to the HUD-1 Settlement Statement, The borrower provided a \$1,113 earnest money deposit, and gave another \$236 at closing, for a total investment of \$1,349. At closing the settlement agent paid a total of \$1,455 to pay off a judgment against the borrower. This negative investment of \$106 was paid from the \$4,675 gift from the non-profit donor.

Decatur did not adequately show that the borrower was an acceptable credit risk. The credit report showed that the borrower had debts over \$4,300 and a civil judgment of \$1,455 that was paid off at closing. The credit report showed a history of poor money management and unwillingness to pay debts. The credit report showed a liability of \$2,359 that was in collection. Decatur did not pay this off at closing, and it was not considered in the mortgage credit analysis. The borrower told us that the loan originator knew about this debt but said that they didn't have to show it or pay it off. The borrower said that she still owed this debt.

HUD's file contained an unsigned letter dated October 31, 2001 from the borrower stating that a charged off Universal account was due to her letting someone else get the card in the borrower's name, and that the judgment on a prior residence was due to damages caused by someone else. The borrower told us that she never provided the letter or the information in the letter. The borrower said that the information was not true and that the debts were hers.

The seller raised the sales price from \$109,041 to \$118,491 four months after the initial sales agreement. The second sales agreement showed a higher estimate of gift from a different non-profit donor. The borrower told us that she only knew that the increased sales price had something to do with her needing the gift since she didn't have enough money.

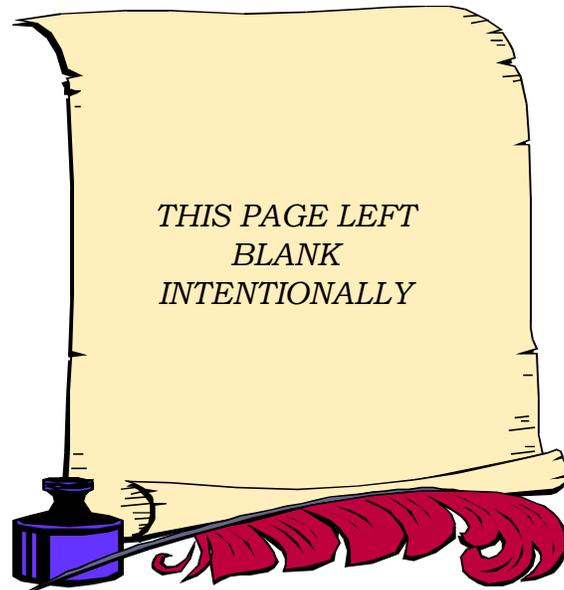
The underwriter (ZLPR Loan Prospector) did not adequately show how the borrower would not be adversely affected as the buy-down expired.

Decatur and the underwriter used an unrealistically low estimate of property taxes in the mortgage credit analysis. The underwriter used \$40 per month, which approximated the taxes on the undeveloped land. Marion County actually assessed \$990 on the property as a developed property, which was about \$82 per month.

The appraisal (by JWM17R) used four comparable properties that were all within the same subdivision as the subject property, and were likely built and sold by the same builder/seller as the subject property. Two comparables were over six months prior to the appraisal. Three of the comparables were shown as being from the builder and Appraiser files. The Appraiser stated that supply and demand were in balance but cited a lack of similar reported sales to justify using old comparables.

Status of Claims Paid

| FHA Loan Number | Status | Mortgage Amount | Claim Paid By HUD | HUD's Computed Sale Loss |
|-----------------|------------|-----------------|-------------------|--------------------------|
| 151-6605466 | Default | \$152,605 | \$0 | \$0 |
| 151-6647913 | Delinquent | \$167,779 | \$0 | \$0 |
| 151-6387115 | Default | \$164,328 | \$0 | \$0 |
| 151-6396198 | Delinquent | \$132,559 | \$0 | \$0 |
| 151-6907158 | Delinquent | \$117,080 | \$750 | \$0 |
| 151-6957663 | Default | \$127,585 | \$0 | \$0 |
| 151-6610262 | Default | \$153,772 | \$0 | \$0 |
| 151-6442972 | Default | \$144,637 | \$0 | \$0 |
| 151-6561313 | Delinquent | \$154,686 | \$650 | \$0 |
| 151-6485246 | Foreclosed | \$150,727 | \$0 | \$0 |
| 151-6510827 | Default | \$158,796 | \$0 | \$0 |
| 151-6531249 | Claim Paid | \$126,672 | \$136,282 | \$60,944 |
| 151-6537560 | Default | \$141,288 | \$0 | \$0 |
| 151-6550730 | Claim Paid | \$133,980 | \$148,454 | \$67,282 |
| 151-6574687 | Delinquent | \$160,014 | \$12,233 | \$0 |
| 151-6611721 | Default | \$136,720 | \$0 | \$0 |
| 151-6471089 | Delinquent | \$148,291 | \$650 | \$0 |
| 151-6443404 | Default | \$142,607 | \$100 | \$0 |
| 151-6838872 | Foreclosed | \$167,728 | \$0 | \$0 |
| 151-6688221 | Delinquent | \$139,156 | \$0 | \$0 |
| 151-6415426 | Claim Paid | \$119,922 | \$132,307 | \$59,696 |
| 151-6649076 | Default | \$164,886 | \$850 | \$0 |
| 151-6642980 | Default | \$149,306 | \$0 | \$0 |
| 151-6589970 | Default | \$167,576 | \$0 | \$0 |
| 151-6463779 | Claim Paid | \$138,852 | \$166,284 | \$67,530 |
| 151-6476419 | Default | \$167,779 | \$4,034 | \$0 |
| 151-6476579 | Claim Paid | \$130,935 | \$142,213 | \$64,912 |
| 151-6477778 | Default | \$128,651 | \$0 | \$0 |
| 151-6482988 | Claim Paid | \$120,785 | \$128,203 | \$51,981 |
| 151-6483461 | Claim Paid | \$165,800 | \$174,454 | \$0 |
| 151-6486054 | Default | \$143,115 | \$750 | \$0 |
| 151-6486185 | Claim Paid | \$110,229 | \$119,055 | \$56,963 |
| 151-6490797 | Default | \$111,954 | \$0 | \$0 |
| 151-6494487 | Default | \$105,864 | \$0 | \$0 |
| 151-6507102 | Claim Paid | \$132,660 | \$138,025 | \$58,437 |
| 151-6527323 | Claim Paid | \$134,842 | \$144,970 | \$70,131 |
| 151-6542156 | Default | \$153,924 | \$0 | \$0 |
| 151-6567251 | Claim Paid | \$151,539 | \$162,252 | \$0 |
| 151-6584264 | Claim Paid | \$156,259 | \$166,098 | \$55,089 |
| 151-6584501 | Claim Paid | \$134,893 | \$145,898 | \$62,098 |
| 151-6588010 | Default | \$116,623 | \$0 | \$0 |
| Totals | | \$5,827,404 | \$1,924,512 | \$675,063 |



Auditee Comments and OIG's Evaluation

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August 13, 2004

VIA FEDERAL EXPRESS

Tom Towers
Assistant Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
477 Michigan Avenue
Room 1780
Detroit, Michigan 48226-2592

**Re: Decatur Mortgage Company, LLC
HUD OIG Draft Audit Report**

Dear Mr. Towers:

As you know, Kirkpatrick & Lockhart LLP represents Decatur Mortgage Company, LLC ("Decatur") in connection with the above-referenced matter. Decatur is in receipt of the Draft Audit Report ("Report"), dated July XX, 2004, from the U.S. Department of Housing and Urban Development Office of Inspector General ("OIG"). Enclosed please find three copies of Decatur's written response to the Report, including supporting documentation. If you have any questions concerning these materials, please call me at (202) 778-9027. We trust that the OIG will forward us a copy of its final report.

Thank you for your kind consideration.

Sincerely,



Phillip L. Schulman

Enclosures

cc: Paul Shoopman
Thomas H. Meyer

DC-661058 v1 0307194-0100

BOSTON ■ DALLAS ■ HARRISBURG ■ LOS ANGELES ■ MIAMI ■ NEWARK ■ NEW YORK ■ PITTSBURGH ■ SAN FRANCISCO ■ WASHINGTON

August 13, 2004

VIA FEDERAL EXPRESS

Tom Towers
Assistant Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
477 Michigan Avenue
Room 1780
Detroit, Michigan 48226-2592

**Re: Decatur Mortgage Company, LLC
HUD OIG Draft Audit Report**

Dear Mr. Towers:

Homebuilders Financial Network, LLC ("HFN") and Dura Homes, Inc. ("Dura Homes") are in receipt of the Draft Audit Report ("Report"), dated July XX, 2004, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of Inspector General ("OIG"). The Report is based on a review of Decatur Mortgage Company, LLC ("Decatur" or "Company"), a company that was owned by HFN and Dura Homes. The OIG performed its review between September 2003 and May 2004, and the audit covered the period between September 2001 and August 2003.

The Report contains two findings, alleging loan origination/underwriting deficiencies in 41 Federal Housing Administration ("FHA") insured mortgage loans that Decatur originated and insufficient Quality Control, with recommendations to the Department for administrative action against Decatur, its owners, and/or the Company's sponsors. The Report states that the purpose of the OIG audit was to determine Decatur's compliance with HUD/FHA requirements for loan origination and Quality Control.

Significantly, the Report largely fails to identify specific statutes, regulations, or guidelines that support its allegations and conclusions. In fact, the Report reflects the OIG's repeated misunderstanding and/or misapplication of HUD/FHA requirements, attempts to impose standards that did not exist at the time the loans cited in the Report were originated, and ignores FHA directives that Direct Endorsement underwriters, not loan correspondents like Decatur, have primary if not sole responsibility for the matters raised in the Report. Furthermore, the Department addressed most of the issues noted in the OIG's findings during a 2002 HUD Quality Assurance Division proceeding, and Decatur resolved many of the issues in early 2003, prior to the OIG audit. Eight of the

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individual loans cited in Finding 1 were actually included in the Quality Assurance Division proceeding, and HUD determined that these loans and the issues raised throughout the proceeding ultimately were the underwriter's responsibility. Nevertheless, the OIG raises the same issues again in the Report. The suggestion in the Report that a loan correspondent and/or its principals should be accountable for subjective underwriting decisions or technical loan origination deficiencies is at odds with FHA guidelines and HUD's traditional manner of addressing these types of alleged deficiencies. This is especially true in this case given that Decatur voluntarily withdrew its FHA approval and filed Articles of Dissolution with the State of Indiana in November 2003.

As set forth below, this response: (I) summarizes Decatur's history and operations; and (II) addresses the individual findings in the Report. It contains information clarifying certain errors and misconceptions, as well as responds to the OIG's specific allegations and recommendations. After reviewing this response and supporting documentation, we hope the OIG will agree not only that Decatur substantially complied with FHA requirements in connection with the matters raised in the Report, but that the recommendations in the Report are disproportionate to the alleged deficiencies. We appreciate the additional time that the OIG has afforded to reply to the Report, as well as this opportunity to comment on the OIG's findings and recommendations.

I. INTRODUCTION / BACKGROUND

Decatur was formed as a limited liability company ("LLC") in Indiana on January 20, 1998, under the name Dura Mortgage Company, LLC ("Dura Mortgage"). Effective November 12, 2002, Dura Mortgage changed its name to Decatur. The original members of the LLC were HFN, Dura Homes, and A.F.S. Investment, Inc. ("A.F.S."). HFN and Dura Homes each owned a 45% interest in the LLC, and A.F.S. owned a 10% interest in the LLC. On May 6, 2002, A.F.S. assigned its 10% interest in the LLC to Dura Homes.

Decatur operated through its home office and one branch office in Indianapolis. It was a small mortgage broker and employed a total of only eight individuals, two at its home office and six at its branch office. Decatur received approval to participate in HUD's FHA mortgage insurance programs as a non-supervised loan correspondent mortgagee in March of 2000, and approximately 75% of the Company's business operations consisted of FHA lending. The Company's primary sponsors included National City Mortgage and Prime Mortgage. Although a small loan correspondent, Decatur took its loan origination responsibilities and relationship with the Department seriously. The Company was committed to low-income and minority borrowers, who

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constituted 60% to 70% of the Company's clientele, and shared the Department's goal to make the American dream of homeownership a reality for underserved groups.

Decatur was a loan correspondent mortgagee, not a Direct Endorsement lender. As a loan correspondent, Decatur gathered information about mortgage loan applicants and submitted the information to Direct Endorsement lenders for analysis. The Company took loan applications, gathered verification forms, credit reports and other documentation, and furnished these items to its sponsors for underwriting and approval. Decatur did not underwrite or approve any of the loans that it originated, and it therefore did not make any credit decisions. FHA guidelines prohibited Decatur from engaging in underwriting activities, and the Company's sponsors were solely responsible for such functions. In fact, the Department routinely has recognized the differing obligations of loan correspondents and sponsors by directing indemnification requests to sponsors, not loan correspondents, as part of Quality Assurance Division and Mortgagee Review Board proceedings.

The language in the Report suggests that Decatur routinely originated ineligible loans for FHA insurance endorsement and that the Company somehow posed a threat to the FHA. To the contrary, Decatur originated quality home loans. While Decatur experienced a high default/claim rate at its branch office at times in the past, Decatur identified this issue and took a number of steps to improve its default/claim rate, thereby evidencing the quality of its loan originations.

Specifically, for the two-year period ending December 31, 2002, the default/claim rate at Decatur's home office exceeded the Credit Watch Termination threshold and HUD ultimately terminated the office. Even prior to the termination in June 2003, however, Decatur had taken a number of steps to address loan performance issues. The loans forming the basis of the Credit Watch Termination were no longer reflective of Decatur's originations. For example, in February 2002, the Company hired a more experienced Branch Manager who reviewed all loan applications prior to submitting them to loan sponsors for underwriting and approval. By June 2002, Decatur had replaced all support staff in the branch with more knowledgeable and experienced personnel, and in March 2002, the Company discontinued its acceptance of downpayment assistance funds from the Housing Action Resource Trust ("HART"). In addition, Decatur's primary sponsor initiated tighter underwriting controls in an effort to reduce the number of early payment defaults. Decatur worked with the sponsor to implement changes necessary to meet these new underwriting standards. The sponsor's new controls included, among other things:

- a cap on the qualifying ratios at 29% and 41% in connection with adjustable rate mortgages and temporary buydowns;

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- a requirement that borrowers have good credit for at least the past 12 months, even in cases where loans are approved by an automated underwriting system;
- a requirement that three compensating factors expressly accepted by HUD be documented for borrowers with credit scores below 585 and/or back-end ratios that exceed 41%; and
- a prohibition against loan approval for borrowers with any late payments following a bankruptcy.

Finally, Decatur conducted a review of the types of FHA loans originated by the Company in an effort to discover any correlation between the types of loans and Decatur's high default/claim rate. The Company determined that it had been focusing on inherently risky transactions, including loans on new construction and loans to first-time homebuyers, as well as on downpayment assistance funds needed to finance these types of loans. In fact, 85% of the early payment defaults or claims on loans originated by Decatur as of mid-2003 involved downpayment assistance.

Notably, Decatur's corrective actions proved successful and the Company's default/claim rate substantially improved. For instance, as of February 28, 2003, only two of the Company's 50 defaults had closed after February 2002. In addition, while the number of early payment defaults in 2001 amounted to about five per month, the number in 2002 amounted to fewer than one per month. While 59 loans defaulted in 2001, only eight defaulted in 2002, and all eight defaulted prior to June 2002. Decatur independently identified the high number of defaults at its branch and took swift and successful action to improve loan performance. Finally, for reasons unrelated to this review, Decatur voluntarily withdrew its FHA approval and ultimately dissolved the Company in November 2003.

II. RESPONSE TO FINDINGS

The Report contains two findings with recommendations for administrative action by HUD. Contrary to the allegations in the Report, Decatur substantially complied with FHA requirements in connection with the matters raised in the findings, and the OIG's recommendations are disproportionate to the alleged deficiencies. We address each finding in turn below.

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A. FINDING 1 – DECATUR COMPLIED WITH FHA LOAN ORIGINATION REQUIREMENTS

In Finding 1, the Report alleges that Decatur did not originate 41 FHA-insured loans in compliance with HUD's requirements and prudent lending practices. It alleges a number of deficiencies involving borrowers' income, appraisals, credit, gift funds, source of funds, living expenses and property taxes, and third parties' handling of file documentation. The Report suggests that Decatur's poor loan originations stemmed from three areas: a lack of management oversight; the origination of loans on properties sold by one of its parent providers; and a failure to implement an adequate Quality Control Plan. The Report recommends that the Department require Decatur and/or its sponsors to indemnify HUD in connection with the loans cited in Finding 1, take administrative action against the owners of Decatur, and, to the extent Decatur may re-apply for HUD approval as a loan correspondent in the future, ensure that the Company's owners implement adequate procedures and controls for loan origination.

Contrary to the suggestion in the Report, Decatur substantially complied with FHA loan origination requirements in connection with the loans cited in Finding 1. Initially, please note that there was sufficient management oversight at the Company's two offices and, as discussed below in reply to Finding 2, Decatur ensured the performance of Quality Control reviews of its loan files and operations. With respect to management oversight, Decatur's Branch Manager was responsible for, among other things:

- managing daily branch office operations;
- supervising mortgage loan counselors, loan processors and other branch employees;
- ensuring that branch personnel adhered to applicable requirements;
- updating Company staff on new policies and procedures;
- preparing monthly operating reports;
- ensuring that loans were processed in a timely manner;
- reviewing the work of staff for quality, completeness, and timeliness;
- instituting measurement processes to ensure quality loan origination activities;

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- reviewing loan application packages to ensure they contained required documentation; and
- conducting routine employee performance reviews.

In addition, HFN performed certain managerial functions for Decatur. As part of its management responsibility, HFN's Regional Vice President of Production, to whom the Branch Manager reported, spent one week on site at Decatur's branch office every quarter in order to review the branch office's activities and act as an on-site resource for loan origination. HFN also assigned to the branch office a Branch Operations Director ("BOD") at HFN. The BOD acted as the branch's primary contact and liaison for all operational and loan coordination activities. In addition, HFN followed a Quality Control manual and loan review process with respect to Decatur's FHA loan origination transactions that the Department reviewed and approved during numerous Quality Assurance Division reviews over the past nine years. Pursuant to the Quality Control and loan review process, HFN reviewed a percentage of Decatur's closed FHA loans each month, issued reports of its findings, and coordinated appropriate remedial action. Finally, HFN monitored FHA Connection/Neighborhood Watch for defaults on Decatur's FHA loan originations and assisted the Company in implementing measures to ensure stable default/claim rates.

Moreover, the fact that Decatur originated mortgage loans on properties sold by Dura Builders, Inc. ("Dura Builders"), a company with common ownership with one of Decatur's members and that sold properties financed by mortgagees other than Decatur, in no way tainted the Company's loan originations. The assertion in the Report that this relationship somehow defiled the Company's loan originations is unfair, unfounded, and untrue. Decatur took its mortgage loan origination responsibilities seriously and originated all loans, FHA and otherwise, with equal care and consideration. At no time did Decatur originate a loan merely for the sake of selling a property owned by Dura Builders. Furthermore, while we address the specific allegations and recommendations in Finding 1 below, it is crucial in this instance to note that the matters raised in Finding 1 involve underwriting functions performed by Direct Endorsement lenders, not by Decatur.

1. The Findings Involve Underwriting Issues

The Report alleges several types of deficiencies in Finding 1, including: (1) failure to verify or support income; (2) acceptance of questionable appraisal practices; (3) failure to investigate credit inquiries; (4) failure to demonstrate creditworthiness; (5) failure to show the timing of gift transfers from nonprofit donors; (6) use of gift funds to pay off debts; (7) failure to document the source of funds; (8) understated living expenses and property taxes; and (9) acceptance of wage information and explanatory

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letters handled by third parties. The Report suggests that Decatur was responsible for all of these alleged deficiencies.

We understand and appreciate that an underwriter relies in part on documentation received from a loan correspondent in determining whether FHA financing is appropriate, and Decatur took care to ensure that it submitted accurate and complete documentation to its sponsors. At no time did Decatur furnish information it knew to be deficient, and the Company worked hard to obtain as much information as possible to assist its sponsors in making underwriting decisions. Nevertheless, to the extent the OIG has concerns that documentation submitted by Decatur was insufficient to qualify a borrower for FHA financing, it was the underwriter's responsibility to determine whether additional documentation was needed, obtain the necessary items (through Decatur or otherwise), and delay FHA approval until such time as all necessary documentation was received. Here, most if not all of the deficiencies alleged in Finding 1 relate to underwriting functions performed by the Company's sponsors and in which Decatur could not have participated. In fact, as described below, the language in the Report itself implies that any concerns with respect to Finding 1 should be addressed directly with the Company's sponsors.

a. The Deficiencies Alleged in Finding 1 Involve Underwriting Functions that Conflict with the Nature of Loan Correspondent Activities

As a non-supervised loan correspondent mortgagee, Decatur's business activities consisted of loan origination and processing. According to the Department's regulations, and as recognized on page 5 of the Report, a loan correspondent is a mortgagee that has as its principal activity the origination of mortgages for sale or transfer to its approved sponsor(s). See 24 C.F.R. § 202.8(a)(2); see also HUD Handbook 4060.1 REV-1, ¶¶ 1-3(C), 3-4. The Department permits either a loan correspondent or its sponsor to perform loan processing functions, see HUD Handbook 4060.1 REV-1, ¶ 2-25, Mortgagee Letter 94-56, and FHA guidelines have identified those functions that constitute loan origination and processing, as opposed to underwriting. Notably, according to FHA guidelines, the matters raised in Finding 1 all fall within the category of underwriting and conflict with the very nature of a loan correspondent's business activities.

Specifically, FHA guidelines provide that loan origination and processing functions include:

- taking the original loan application;
- conducting the face-to-face interview, as required;

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- requesting the FHA Case Number;
- completing and furnishing the Truth in Lending form;
- completing and furnishing the Good Faith Estimate;
- procuring Verifications of Deposit and Employment;
- ordering the credit report;
- ordering the appraisal; and
- preparing closing documentation.

See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-13; Mortgagee Letter 94-56. As noted in the Report, the Department has also identified 14 mortgage broker functions normally performed in the origination of a loan, as set forth in HUD's Statement of Policy 1999-1 ("Policy Statement"), regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. §§ 2601 et seq. These functions include:

- (1) taking information from the prospective borrower and filling out the application;
- (2) analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;
- (3) educating the prospective borrower in the home buying and financing process, advising the prospective borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;
- (4) collecting financial information (e.g., tax returns and bank statements) and other related documents that are part of the application process;
- (5) initiating/ordering Verifications of Employment and Verifications of Deposit;

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- (6) initiating/ordering requests for mortgage and other loan verifications;
- (7) initiating/ordering appraisals;
- (8) initiating/ordering inspections or engineering reports;
- (9) providing disclosures (e.g., Truth in Lending forms and Good Faith Estimates) to the prospective borrower;
- (10) assisting the prospective borrower in understanding and clearing credit problems;
- (11) maintaining regular contact with the prospective borrower, realtors, and lender between application and closing to apprise them of the status of the application and gather any additional information as needed;
- (12) ordering legal documents;
- (13) determining whether the property was located in a flood zone or ordering such service; and
- (14) participating in the loan closing.

None of the loan origination or processing functions set forth in the FHA guidelines or Policy Statement suggest that a loan correspondent performs the types of activities referenced in Finding 1 of the Report. All of the functions described in the HUD guidelines, other than prequalifying the borrower and determining whether the property is located in a flood zone, indicate that a loan correspondent is responsible for "taking," "conducting," "requesting," "completing," "procuring," "ordering," "preparing," "collecting," "initiating" or "providing" certain information and documentation. In other words, a loan correspondent procures information and documentation and submits them to a sponsor for underwriting analysis. None of the functions described by HUD suggest that a loan correspondent should analyze the file documentation to make the types of determinations referenced in Finding 1.

For example, Finding 1 alleges that Decatur accepted questionable appraisal practices. With respect to property valuation, however, the Department indicated in the Policy Statement that a typical function of brokers is "initiating/ordering" the appraisal, not evaluating the appraisal. Moreover, as discussed in detail below, HUD expressly defines appraisal review as an underwriting function. See, e.g., HUD Handbook 4000.4

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REV-1, CHG-2, ¶ 2-13. Similarly, Finding 1 alleges that Decatur did not verify or support income or document the source of funds in some cases. With respect to these matters, however, HUD indicated in the Policy Statement that brokers' functions include "[i]nitiat[ing]/order[ing] VOs (verifications of employment) and VODs (verifications of deposit)" and "[c]ollect[ing] financial information (tax returns, bank statements) and other related documents that are part of the application process[.]" Neither the Policy Statement, nor any other FHA provision of which we are aware, suggests that a loan correspondent analyzes the employment or financial documentation to determine the borrower's effective income or assets available for closing. The underwriter makes these determinations and reflects them on the Mortgage Credit Analysis Worksheet ("MCAW"), which the underwriter, not the broker, is required to complete. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 3-16 and Appendices 3 and 4.

Like appraisal, income, and source of funds determinations, the remaining matters identified in Finding 1 involve underwriting determinations. FHA guidelines expressly recognize this fact and Decatur did not participate in the referenced activities.

b. Decatur Did Not Participate in the Matters Raised in Finding 1

Not only are the functions described in Finding 1 antithetical to the very nature of a loan correspondent's business, but Decatur did not participate in these functions. In fact, FHA guidelines recognize that a loan correspondent cannot make the types of determinations referenced in Finding 1 and therefore require an underwriter, not a loan correspondent, to certify to such matters. For example, two certifications must accompany a lender's request for mortgage insurance, one by the mortgagee and one by the underwriter. In a brokered transaction, the loan correspondent executes the mortgagee certification and the sponsor executes the underwriter certification. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 3-16. Significantly, the issues raised in Finding 1 of the Report are included in the underwriter certification, not in the mortgagee certification. See HUD Handbook 4000.4 REV-1, CHG-2, Appendices 3 and 4. The underwriter certification requires the underwriter to certify that he or she has personally reviewed, among other things, the following items and ensured their compliance with FHA standards:

- the appraisal report;
- the credit application, including the analysis on the MCAW;
- the mortgagor's monthly mortgage payments to ensure they will not be in excess of his or her reasonable ability to pay;

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- the mortgagor's income to ensure it is and will be adequate to meet the periodic payments required to amortize the mortgage submitted for insurance; and
- the mortgagor's general credit standing to ensure it is satisfactory.

All but one of the deficiencies alleged in Finding 1 fall into the aforementioned categories contained in the underwriter certification. The only item referenced in the Report that does not fall into these categories is item (9), which involves the acceptance of wage information and explanatory letters handled by third parties. Moreover, none of the items referenced in Finding 1 are included in the mortgagee (loan correspondent) certification.

In addition, FHA guidelines effectively prohibit loan correspondents from performing the underwriting functions referenced in the Report. For example, the Department has stated that, "since loan correspondents cannot perform any underwriting function (i.e., review of the appraisal, mortgage credit examination or underwriting), no specific Direct Endorsement training is required for the correspondent." HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-13 (emphasis added). Additionally, the FHA guideline cited as the basis for the substantive allegations in Finding 1 is the Mortgage Credit Analysis Handbook, 4155.1 REV-4, CHG-1.¹ Significantly, this Handbook applies to underwriting requirements and guidelines, not to loan correspondent requirements. The Handbook begins:

This Handbook describes the basic mortgage credit underwriting requirements for single-family (1-4 units) mortgage loans insured under the National Housing Act. For each loan HUD insures, the lender must establish that the borrower has the ability and willingness to repay the mortgage debt. The decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout this Handbook and must be supported by sufficient documentation.

HUD Handbook 4155.1 REV-4, CHG-1, Forward (emphasis added). Again, the Department indicated that Decatur, as a loan correspondent, could not perform such functions. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-13.

¹ While the Department has issued a new Mortgage Credit Analysis Handbook, 4155.1 REV-5, the new Handbook became effective for loan applications taken on or after January 1, 2004, after the loans cited in the Report were originated and closed. We therefore rely on the prior Handbook, 4155.1 REV-4, CHG-1, and accompanying Mortgagee Letters throughout this response.

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Furthermore, in describing underwriter responsibilities, the Department has stated that "HUD looks to the underwriter as the focal point of the Direct Endorsement program" and that the underwriter is responsible for, among other things: (i) ensuring a loan's compliance with HUD instructions and overall acceptability for HUD insurance; (ii) coordinating all phases of underwriting and the quality of loan decisions; (iii) reviewing appraisal reports, compliance inspections and credit analyses; (iv) determining the acceptability of the appraisal and inspections; and (v) determining the borrower's capacity to repay the mortgage. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-4(C). Thus, according to FHA guidelines, the matters raised in Finding 1 involve underwriter determinations in which Decatur could not participate and for which Decatur was not responsible.

Finally, as a loan correspondent, Decatur would have been ill-qualified to make determinations regarding the borrowers' creditworthiness and other matters raised in Finding 1. Decatur essentially acted as a loan processor in the cited cases, and it is not the duty of a loan processor to review a borrower's file as a whole or determine such matters as effective income and creditworthiness. Only the underwriter has the ability to review all of the supporting documentation collectively to elicit a complete financial picture of the borrower's application. A loan processor is not in a position to elicit the complete financial picture and so cannot be held accountable for the underwriting decision. It is for this reason that underwriters are required to meet certain qualification standards and register with HUD to be eligible to make the types of determinations referenced in Finding 1. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-4; Mortgagee Letter 96-10. As a loan correspondent, Decatur was not required to and did not meet those standards, and it therefore should not be held to the same requirements as underwriters.

c. The Language in the Report Implies that Concerns Regarding Finding 1 Should be Addressed Directly with Decatur's Sponsors

Not only do FHA guidelines provide that the matters raised in the Report relate to the underwriting of the loans, but the language in the Report itself implies that it would be more appropriate to address the concerns identified in the findings directly with Decatur's sponsors for at least four reasons. First, page 5 of the Report acknowledges that, "[a]s a loan correspondent, Decatur's principal activity is the origination of mortgages for sale or transfer to an approved sponsor under HUD's Single Family Direct Endorsement Program." (emphasis added) As discussed above, loan "origination" does not include determining effective income, analyzing appraisals, determining creditworthiness, and performing the other types of functions referenced in the Report. These functions were performed by the underwriters, not Decatur. The Report seems to recognize this distinction in the Introduction when it states: "The loan

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origination process includes taking initial loan applications, initiating the appraisal assignment, obtaining the credit report, and procuring verifications of deposit and employment." (emphasis added) While we do not mean to suggest that a broker may submit information to a sponsor that it knows to be deficient, and while Decatur at no time knowingly submitted deficient information or documentation to a sponsor, it is the underwriter's duty to ensure that the information and documentation received are consistent and satisfy HUD/FHA requirements and that the file contains all documents necessary to approve the loan.

Second, page 13 of the Report acknowledges that sponsors are responsible to HUD for the actions of their loan correspondent lenders in originating loans, unless it has affirmative evidence that it neither knew nor should have known of the loan correspondent's actions. See 24 C.F.R. § 202.8(b)(7); see also HUD Handbook 4060.1 REV-1, ¶ 3-4(A). The Report further acknowledges that the deficiencies cited in Finding 1 "represent actions by Decatur that its sponsors should have had specific knowledge of. As such, the sponsors were responsible to HUD for giving underwriter approval to the loans originated and processed by Decatur, and should be pecuniarily responsible for loans that were not processed in accordance with HUD's requirements and prudent lending practices." The Report thereby recognizes that the concerns raised in Finding 1 relate to the responsibilities of the Direct Endorsement lenders, not Decatur.

Third, throughout Appendix C to the Report, which contains individual write-ups of the allegations in each of the 41 files cited in Finding 1, the OIG repeatedly alleges the underwriter's failure to determine effective income, analyze the appraisal, determine the borrower's creditworthiness, determine the property taxes, and make other decisions. The Report thereby recognizes that the issues underlying the alleged deficiencies relate to underwriting functions that were not Decatur's responsibility.

Finally, page 13 of the Report acknowledges that many of the deficiencies identified in Finding 1 were also identified by HUD during a Quality Assurance Division proceeding in September 2002. In fact, a letter from the HUD Quality Assurance Division, dated January 31, 2003, identified all of the issues raised in Finding 1 of the Report other than appraisals (**Exhibit A-1**). After considering Decatur's written response (**Exhibit A-2**), the Quality Assurance Division indicated that it had addressed most of the alleged deficiencies with Decatur's sponsor, and it did not seek indemnification from the Company (**Exhibit A-3**). Note that eight of the loans cited in Finding 1 of the Report were resolved with HUD during the Quality Assurance Division proceeding. As evidenced during the 2002 HUD proceeding, the Department traditionally has imposed penalties against underwriters, not loan correspondents, for the types of deficiencies alleged in Finding 1.

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Having said that, we understand and appreciate that a sponsor mortgagee underwrites a loan based in part on the information gathered by the loan correspondent. For this reason, Decatur at all times exercised due care and followed prudent lending practices when originating FHA mortgage loans.

2. Decatur Substantially Complied with FHA Loan Origination Requirements in the Cited Cases

Finding 1 cites 41 loans. The OIG summarized the findings in these cases in the body of the Report and included an individual write-up for each loan in Appendix C. A review of the files revealed that the allegations in Finding 1 involve underwriting matters for which Decatur was not responsible and that many of the findings are incorrect. In many cases, it appears that the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not involve material deficiencies affecting the underlying loans' insurability. We address the different categories of allegations below.

a. Borrower Income

The Report alleges that, in 17 cases, Decatur did not properly verify or support the borrower's income. Specifically, it alleges that Decatur used rental income of other properties owned that was not verified in three cases and that it used overstated or unstable income in 17 cases. The Report cites Paragraph 2-7 of the Mortgage Credit Analysis Handbook, 4155.1 REV-4, CHG-1, as the basis for these allegations.

Initially, note that the income issue raised in the Report is related strictly to the underwriting of the loan, not to loan origination or processing activities. The Report faults Decatur for overestimating borrowers' income. The underwriter, however, determined each borrower's effective income and reflected such income on the MCAW in order to calculate the borrower's qualifying ratios. Decatur was not involved in this process. While Decatur collected and furnished employment and income documentation to the sponsor, the sponsor's underwriter, not Decatur, reviewed the documentation and determined the borrower's effective income for qualifying purposes. In fact, the individual write-ups contained in Appendix C of the Report reference the income that the "underwriter used." Thus, to the extent the OIG is concerned that the borrower's income may have been miscalculated in any given case, we respectfully submit that this issue should be addressed directly with the sponsor. Nevertheless, we would like to take this opportunity to address the two cases specifically referenced in the body of the Report.

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i. [REDACTED] - FHA Case No. 151-6605466

In the [REDACTED] case, Finding 1 alleges that Decatur did not adequately verify rental income on the borrower's current residence. It states that Decatur provided a copy of a rental agreement for the borrower's current address, which was dated the same day as the subject sales agreement and showed monthly rent payments of \$650, and a copy of an August 2000 rent check. Finding 1 alleges, however, that there was no evidence the August 2000 check was cancelled, that a Credit Union Draft History in the loan file through August 30, 2000 did not show any deposits of \$650 to support the rent payments were actually being received, and that the initial loan application, dated June 20, 2002, did not show any rental income despite the rental agreement dated June 16, 2002. Finding 1 further alleges that, in an interview with the borrower, the borrower indicated that the seller's sales staff had provided her with a lease form and that she completed the form and had her son's girlfriend provide a rent check. The borrower allegedly stated that the seller knew the lease was invalid, that she discarded the rent check after the seller copied it for the file, that she never received any rent for her prior residence, and that Decatur never asked her about her income, debts, or the lease from the prior residence. Finally, Finding 1 alleges that the underwriter used \$3,818 per month as effective income, but that the Verification of Employment ("VOE") supported only \$3,668.

With respect to the borrower's rental income, Decatur properly obtained a rental agreement and copy of a rent check (**Exhibits B-1 and B-2**). Decatur received these items from the borrower and had no reason to question the borrower's veracity. The borrower should not have completed and executed the rental agreement if it was not factual. Moreover, after reviewing the [REDACTED] transaction, the homebuilder's sales agent confirmed that the borrower herself furnished the rental information and that the seller had no knowledge of any misinformation provided by the borrower. To the extent the rental income may not have been received, Decatur neither knew nor should have known of any such deficiency in the file. As the loan correspondent, Decatur was not required to and did not analyze the rental documentation or bank statements to determine the amount of the purported rental income. In accordance with typical broker activities, the Company obtained the rental documentation and submitted it to the underwriter for review. While Decatur would not have forwarded the documentation to its sponsor had it known of the alleged deficiencies, please note that the Company did not instruct the borrower to create an invalid lease or check and had no reason to suspect any wrongdoing by the parties to the transaction.

As you may know, the incontestability clause of the National Housing Act ("NHA") restricts the circumstances under which the Department may terminate its contract of insurance with a mortgagee to those where the mortgagee had actual or constructive knowledge of fraud or misrepresentation. Specifically, the NHA provides that:

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Any contract of insurance heretofore or hereafter executed by the Secretary under this title shall be conclusive evidence of the eligibility of the loan or mortgage for insurance, and the validity of any contract of insurance so executed shall be incontestable in the hands of an approved financial institution or approved mortgagee from the date of the execution of such contract, except for fraud or misrepresentation on the part of such approved financial institution or approved mortgagee.

12 U.S.C. § 1709(e) (emphasis added). Those courts that have considered the NHA's incontestability clause generally agree that the Department may not challenge the validity of an FHA insurance policy or deny insurance unless the mortgagee engaged in fraud or misrepresentation. See, e.g., Ashton Acres Apartments, Ltd. v. The United States of America, No. 84-6395, 1985 U.S. Dist. LEXIS 20810, *13 (E.D. Pa. April 12, 1985) ("Although there are few cases on the issue, it is apparent that the clearly expressed purpose of § 203(e) is to prevent HUD from denying the validity of an insurance contract; once the guarantee has been issued, the Secretary cannot claim that the mortgage was ineligible in order to defeat the claim of the lender, in the absence of fraud by the latter. . . . [The] decision that the mortgage was eligible . . . is now immutable.") (citing Jay F. Zook, Inc. v. Brownstein, 237 F. Supp. 800 (N.D. Ohio 1965)). In fact, the Department traditionally has not held a lender responsible for fraud committed by the borrower, seller, real estate agent, or others absent actual or constructive knowledge on the part of the lender.

Here, Decatur obtained the rental information and documentation from the borrower and submitted them to the sponsor with the loan application package. The Company had no reason to doubt the borrower's certification in the rental agreement, and there is no evidence that Decatur employees knowingly submitted false information to its sponsor. To the extent the borrower may have furnished incorrect information or documentation, it appears that the borrower may have perpetrated a fraud against Decatur, the underwriter, and the Department. Decatur, however, was not involved in any such transgression.

With respect to the use of \$3,818 per month as effective income, as recognized in Appendix C of the Report, the underwriter, not Decatur, determined the borrower's effective income for qualifying purposes. Thus, to the extent the OIG disagrees with the income used, we respectfully submit that this matter should be addressed directly with the underwriter.

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ii. [REDACTED] FHA Case No. 151-6542156

In the [REDACTED] case, Finding 1 alleges that Decatur included Social Security benefits received as other income for the borrower's two children, ages 16 and 17, and that the benefit letter was provided in both the HUD and mortgage files showing total benefits of \$716. It alleges, however, that Decatur and the underwriter used an amount that was grossed up by 25% without documentation as to the reason for grossing up the income. In Appendix C, the individual write-up also alleges that the underwriter overstated the Social Security income because the children were entitled to receive Social Security benefits until they reach age 18 and therefore would not have received the income for at least three years given their ages.

Initially, please note that the underwriter, not Decatur, determined the amount of Social Security income in this case and made the decision to include such income in the borrower's effective income for qualifying purposes. Decatur properly obtained copies of the Social Security benefit letters (**Exhibit C-1**) and the loan application disclosed the ages of the borrower's children (**Exhibit C-2**). The Company diligently furnished the information it received to the underwriter for analysis, and the underwriter decided how to treat the income in the transaction. The Report recognizes as much in its allegation that the "underwriter" overstated the income. We therefore respectfully submit that any concerns in connection with this matter should be addressed directly with the underwriter.

Nevertheless, it appears that the income may have been properly determined in the [REDACTED] case. With respect to the continuance of Social Security benefits for the two children, we understand that an underwriter should include such benefits in effective income only if they will continue through the first three years of the mortgage. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-7(E). In this case, we are unsure of the basis for the allegation that the Social Security benefits would terminate when the borrower's children turned 18. Although Social Security benefits for children typically cease when a child reaches the age of 18, there are certain exceptions to this age restriction. For example, Social Security benefits will be available to children over 18 who are still in high school or who are disabled. Thus, the benefits may have been expected to continue in this case. Moreover, the borrower may still have qualified for FHA financing even without considering the children's Social Security income. Again, however, the underwriter, not Decatur, determined that the income was likely to continue. With respect to the 25% increase, we understand that the underwriter grossed up the income by 25% in accordance with the Department's rules regarding non-taxable income. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-7(P); Mortgagee Letter 00-24.

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b. Appraisal Reports

The Report alleges that, in 32 cases, Decatur did not document any analyses by underwriters of the appraisal reports to ensure they were acceptable. It further alleges that the appraiser adjusted the appraised value upwards in five cases when the sales price of the subject property increased, and that the appraiser used comparable properties in 32 cases that were over a mile from the subject properties, sold more than six months prior to the appraisals without adequate explanation, or selected from the same subdivisions as the subject properties. The Report notes that Decatur used the same appraiser in 39 of the 41 cases reviewed.

With respect to the appraiser used in most of the cases, the appraiser had been a certified appraiser in the State of Indiana for nearly 10 years. Decatur is unaware of any concerns regarding her appraisal performance, and the Company had no reason to question her qualifications. With respect to the individual appraisal reports, as previously noted, appraisal review is strictly an underwriting function. While Decatur selected the HUD-approved appraisers to perform the appraisals, the Company was not trained in underwriting issues and its sponsors were responsible for reviewing the appraisals to determine their acceptability. FHA guidelines expressly recognize this distinction between sponsors and loan correspondents.

The Department's guidelines define appraisal review as an underwriting function and thereby prohibited Decatur from performing such reviews. The Single Family Direct Endorsement Program Handbook includes property analysis in the description of underwriting and states that the "underwriter reviews the appraisal report and the mortgage credit analysis to determine the acceptability of the conclusions reached by the appraiser" and "the underwriter determines whether or not the application complies with specific provisions of the HUD program." HUD Handbook 4000.4 REV-1, CHG-2, ¶¶ 1-2(A), (C). It expressly states that the underwriter's review of the appraisal must include verification of the factual information in the appraisal, determination of the plausibility and consistency of the appraiser's conclusions, determination of the consistency of the information in the appraisal as compared to other data conclusions reported in similar cases recently reported, and compliance with underwriting instructions in HUD Handbooks 4145.1 and 4150.1. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 3-3(G). Perhaps most significantly, the Handbook expressly states that: "Since loan correspondents cannot perform any underwriting function (i.e., review of the appraisal, mortgage credit examination or underwriting), no specific Direct Endorsement training is required for the correspondent." HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-13 (emphasis added). Thus, HUD has expressly defined appraisal review as an underwriting function, noted that the Handbooks addressing appraisal requirements are "underwriting instructions," and indicated that loan correspondents cannot perform

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reviews of appraisals. See, e.g., HUD Handbooks 4000.2 REV-2,² 4000.4 REV-1, CHG-2, 4145.1 REV-2, CHG-1, 4150.1 REV-1.

Moreover, while the Report cites Paragraph 1-2(c) of the Single Family Direct Endorsement Program Handbook for the proposition that Decatur should have documented the underwriters' analyses of appraisal reports, this provision states only that the underwriter must review the appraisal report to determine its acceptability, not that a loan correspondent is somehow obligated to document the underwriter's analysis. Such activity is the responsibility of an underwriter, not a loan correspondent. Moreover, the FHA guidelines describing broker functions state that a broker initiates or orders the appraisal, not that a broker reviews or analyzes the appraisal. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-13; Mortgagee Letter 94-56; RESPA Statement of Policy 1999-1. Thus, Decatur was not responsible for determining that the comparable properties or appraised values were acceptable in the cited cases. These determinations belonged solely to the underwriters.

Furthermore, at the time the loans cited in the Report were originated, the FHA provisions stating that a mortgagee would be held equally responsible with the appraiser for deficiencies in appraisals suggested that such accountability was limited to Direct Endorsement lenders. To this end, HUD provided that:

a DE lender that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Depending on the circumstances in a particular case, if HUD finds that the appraisal is so deficient that the adequacy for the security for the loan is compromised or that our risk has been substantially increased, the Department may look to the lender for risk mitigation. . . . When there is a Sponsor/Correspondent relationship between the lenders, the Correspondent must use an appraiser chosen by the Sponsor if the Lender Selection Roster is to be used. The Sponsor will be accountable for the quality of the appraisal.

Mortgagee Letter 94-54 (emphasis added). It was not until HUD revised Parts 25 and 203 of its FHA regulations in July 2004 that the Department clarified that its appraisal accountability policy applies to loan correspondent lenders as well as Direct Endorsement lenders. See 69 Fed. Reg. 43504 (July 20, 2004). Even under this

² The new Single-Family Mortgagees' Handbook, 4000.2 REV-3, was not issued until May 20, 2004. We therefore rely on the former Handbook, 4000.2 REV-2, throughout this response.

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revised rule, however, accountability would not attach to Decatur in the cases cited in Finding 1. The new rule confirms HUD's intent to hold lenders, including loan correspondents, accountable for deficient appraisals only when the lender knew or should have known of the deficiencies. Because a loan correspondent cannot engage in appraisal review, Decatur neither knew nor should have known of any deficiencies regarding comparable sales alleged throughout Finding 1 of the Report, and the Company at no time condoned an appraiser increasing the appraised value of a property without adequate support for the increased value. Decatur had no reason to suspect the integrity of the appraisal reports in the cases cited in Finding 1.

The Report alleges four different types of deficiencies with respect to appraisals. First, in one case, [REDACTED] – FHA Case No. 151-6605466, the Report alleges that the appraisal report was originally dated January 11, 2002 (**Exhibit D-1**), more than six months prior to closing in September 2002 (**Exhibit D-2**). It states that, although the appraisal report was amended on June 28, 2002, the report does not indicate what information was amended. Here, while we understand that an appraisal has a term of six months for existing construction, see HUD Handbook 4000.2 REV-2, ¶ 2-17(B), Decatur ordered an appraisal at the time of loan origination and submitted the report to the sponsor with the application package. Because the closing was delayed, the appraisal was updated closer to the time of closing. It was the underwriter's responsibility, however, not Decatur's, to review the updated appraisal to ensure it satisfied FHA requirements. In any event, the final appraisal certified the appraised value and there is no reason to believe the property was over-appraised.

In all of the remaining cases cited for appraisal deficiencies, other than five discussed below, the Report alleges that the comparable properties used by the appraiser were improper because of their age or location and/or that Decatur did not perform a desk review of the appraisal report. With respect to comparable properties, as a loan correspondent, Decatur was not required to analyze the comparable properties or determine whether they adequately supported the appraisers' final value conclusions. The analysis of comparable properties is included in the performance of an appraisal review, which the Department has expressly defined as an underwriting function. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-13; see also, e.g., HUD Handbooks 4000.2 REV-2, 4145.1 REV-2, CHG-1, 4150.1 REV-1. Having said that, it appears that the allegations regarding comparable properties in the Report are largely unsupported.

For example, in the [REDACTED] case, FHA Case No. 151-6907158, the Report alleges that the appraiser used two comparable properties in the same subdivision as the subject property and that the other two comparable properties were over a mile from the subject property. The Report notes the appraiser's statement that supply and demand were in balance, but lacked current sales in the area. With regard to the two

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comparable properties in the subject property's subdivision, FHA guidelines instruct that, in selecting comparable properties, an appraiser should "[a]void using three builder sales from the same subdivision if possible." HUD Handbook 4150.1 REV-1, ¶ 8-3(O)(1). There is no prohibition, however, against using two comparable properties in the subject property's subdivision. With respect to the two comparable properties located over a mile away from the subject property, the Department has instructed that, "[i]f comparable is more than 1 mile from subject, be sure to explain in the 'Comments' section." HUD Handbook 4150.1 REV-1, ¶ 8-3(O)(3). Here, as acknowledged in the Report, the appraiser did explain the reason for the distance in the appraisal report. Specifically, the appraiser explained that there were no recent sales available from the subject property's development and that the best available comparable properties were selected (**Exhibit E**). It therefore appears that FHA requirements were satisfied in this case.

Similarly, in the [REDACTED] case, FHA Case No. 151-6463779, the Report alleges that one of the four comparable properties was not sold within six months of the appraisal and that the appraiser did not adequately justify its age. The Department, however, permits the use of comparable properties sold more than six months, but less than one year, prior to the appraisal if more recent ones are not available, so long as the appraiser explains his or her decision. See HUD Handbook 4150.2, CHG-1, Appendix D-1. In this case, the appraiser explained that more recent comparable sales were not available (**Exhibit F**). Specifically, the appraiser stated: "Due to a lack of similar recent comparable sales, it was necessary to use comparable sales that were more than six months old and that were more than one mile from the subject. Because the subject is in a stable marketing area, time adjustments were not necessary. All comps are considered reliable." It therefore appears that FHA requirements were satisfied. The remaining files cited in Finding 1 that contain alleged deficiencies concerning the comparable sales involve similar situations and likewise appear to satisfy FHA appraisal requirements.

With respect to the allegation that Decatur did not perform a desk review of the appraisal in some of the cases, the only requirement regarding desk reviews of which we are aware is that a mortgagee must perform a desk review of the property appraisal on all loans chosen for Quality Control review. See HUD Handbook 4060.1 REV-1, ¶ 6-3(C). To our knowledge, there is no other requirement that a loan correspondent perform a desk review of an appraisal. Moreover, such a requirement would be at odds with the FHA guidelines, which consistently provide that appraisal review is an underwriting function that a loan correspondent cannot perform.

Finally, with respect to the five cases where the appraiser allegedly adjusted the appraised value upwards, please note that in no case did Decatur condone an increased value without adequate support for the higher valuation. While the appraiser

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may have changed the property valuation in certain cases, it was the underwriter's responsibility to ensure that the appraiser's conclusions were acceptable. Decatur is not aware of any instance where the property is over-appraised, and the Report offers no evidence that the final valuations are inaccurate.

In sum, FHA guidelines expressly state that appraisal review is an underwriting function that loan correspondents cannot perform, and HUD has recently clarified its intent to hold lenders accountable for appraisal deficiencies only where they knew or should have known of such deficiencies. Given that, in compliance with FHA guidelines, Decatur did not analyze the appraisal reports, the Company neither knew nor should have known of any deficiencies regarding comparable sales in the reports. Moreover, Decatur was not required to perform a desk review of the appraisal in cases that were not selected for Quality Control review, and the Company at no time participated in an appraiser's decision to increase the property valuation without adequate support for doing so. For these reasons, to the extent the OIG or Department may have any concerns regarding the appraisals in the cases referenced in Finding 1, we respectfully submit that such concerns should be directed to the appraisers and/or Direct Endorsement lenders.

c. Borrower Credit

Finding 1 alleges that, in 27 cases, Decatur did not adequately investigate inquiries or additional Social Security Numbers shown on the credit report. It further alleges that, in 36 cases, the underwriter did not provide adequate compensating factors for loans with qualifying ratios that exceed the benchmark guidelines, the underwriter did not adequately explain how borrowers would be expected to meet mortgage obligations as buydown agreements expired, and the files did not adequately establish how borrowers improved their creditworthiness other than having delinquencies paid off from closing proceeds. The Report cites provisions of the Mortgage Credit Analysis Handbook as the basis for these allegations.

Initially, please note that the underwriter, not a loan correspondent, reviews a borrower's credit report and related items and determines whether the borrower is creditworthy. The Department's guidelines repeatedly define mortgage credit analysis as an underwriter function. See, e.g., HUD Handbook 4000.4 REV-1, CHG-2, ¶ 1-2(B) (stating that the Direct Endorsement underwriting process includes mortgage credit analysis), ¶ 2-13 (stating that a loan correspondent "cannot perform any underwriting function (*i.e.*, review of the appraisal, mortgage credit examination or underwriting)"), Appendices 3 and 4 (requiring the underwriter, not a loan correspondent, to certify that a borrower's general credit standing is satisfactory). FHA guidelines also indicate that mortgage broker functions include the "ordering of the credit report," not analyzing the credit report to determine whether the borrower is creditworthy. See Mortgage Letter

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94-56. The Department has expressly stated that the determination of a borrower's willingness and ability to make mortgage payments is to be made by the underwriter. See, e.g., HUD Handbook 4155.1 REV-4, CHG-1, Chapter 2, Section 5; Mortgagee Letter 95-7. As a loan correspondent, Decatur ordered the credit reports and collected other credit documentation in the transactions cited in Finding 1, but the underwriters analyzed these items to determine whether the borrowers were creditworthy and could be expected to make timely mortgage payments. In each case, Decatur presented sufficient documentation to the sponsor for the underwriter to make a determination regarding the borrower's creditworthiness and ability to repay the mortgage. The allegations in Finding 1 repeatedly note the underwriter's, not Decatur's, purported failure to justify the credit decision, and they focus on the OIG's apparent disagreement with the underwriting decisions, not necessarily with the documentation furnished by Decatur. For these reasons, we respectfully submit that any concerns regarding credit analysis should be raised directly with the underwriters that made the credit decisions.

Having said that, we note that a cursory review of the cited files suggests that the findings in the Report involving credit underwriting generally do not constitute violations of FHA requirements. In many cases, it appears that, while the OIG may disagree with the underwriters' decisions, the decisions were permissible under FHA guidelines. While the Department has set forth a myriad of rules and regulations to govern the underwriting of FHA loans, it has also granted authority to Direct Endorsement lenders to exercise discretion in making credit decisions based on the totality of the circumstances. Although certain credit documents must be obtained, it is the underwriter's decision as to whether a particular borrower is creditworthy based on the borrower's overall pattern of credit behavior. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. To this end, the Department has acknowledged that "[u]nderwriting is more of an art than a science and requires the careful weighing of circumstances that affect the borrower's ability and willingness to make timely mortgage payments." Mortgagee Letter 00-24; see also Mortgagee Letter 95-07. Underwriting requires the subjective evaluation of information based on experience in determining whether a potential borrower is creditworthy, and an underwriter must carefully weigh all aspects of an individual's application. Were two underwriters to review the same file, one might approve a loan where the other would deny a loan. Each underwriter, however, may have made a reasonable and prudent underwriting decision. Nevertheless, the OIG second-guesses the underwriters' decisions in many of the cases cited in Finding 1.

For example, the Report alleges that, in 36 cases, the underwriter did not provide adequate compensating factors to offset high qualifying ratios. We understand that an underwriter relies on a borrower's qualifying ratios to determine whether the borrower can be expected to meet his or her housing expenses. The Department has established benchmark guidelines of 29% and 41% for a borrower's mortgage payment-to-income and total fixed payment-to-income ratios, respectively, and noted that greater

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latitude is permissible on the front-end ratio. See HUD Handbook 4155.1 REV-4, CHG-1, ¶¶ 2-12, 2-13. The Department, however, permits an underwriter to rely on compensating factors to approve a loan to a borrower with qualifying ratios that exceed the benchmark guidelines of 29% and 41%, so long as the underwriter lists compensating factors in the Remarks section of the MCAW; HUD references several compensating factors that may be considered. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-13; Mortgagee Letter 97-26; see also Mortgagee Letter 95-07 (recognizing that "each loan is a separate and unique transaction and that there may be other factors that demonstrate the borrower's ability and willingness to make timely mortgage payments."). Moreover, prior to issuance of the new Mortgage Credit Analysis Handbook (4155.1 REV-5), which was not effective at the time the subject loans were originated and underwritten, HUD did not dictate which compensating factors were acceptable, the number of compensating factors that must exist, or the extent to which the benchmark guidelines could be exceeded. HUD expressly delegated all such decisions to the underwriter and did not limit the acceptable compensating factors to any particular items.³ The Department professed that the "FHA does not set an arbitrary percent by which ratios may be exceeded but rather FHA relies on the underwriter to judge the overall merits of the loan application and to determine what compensating factors apply and the extent to which those factors justify exceeding the ratios." Mortgagee Letter 00-24; see also Mortgagee Letter 95-07. Thus, where a potential borrower's qualifying ratios are high, an underwriter must consider all relevant circumstances and exercise discretion in deciding whether compensating factors exist and whether to approve or reject a loan.

In the 36 cases cited in the Report, we understand that the underwriters considered the totality of the circumstances and determined that compensating factors both existed and justified loan approval. While perhaps some of the compensating factors could have been better explained in the Remarks section of the MCAWs, it appears that compensating factors were documented in the loan files. Given that HUD had not yet limited the acceptable compensating factors to those enumerated in the Handbook and had delegated authority to underwriters to determine whether and what compensating factors exist, it appears that the underwriters substantially adhered to FHA requirements in these cases. While the Report questions the underwriting decisions, it fails to identify a violation of any particular FHA requirement and merely expresses disagreement with the underwriters' determinations that compensating factors offset the higher ratios.

³ The new Mortgage Credit Analysis Handbook specifies that the 10 compensating factors enumerated in the Handbook are the only compensating factors that will justify approval of a loan to a borrower with qualifying ratios that exceed the benchmark guidelines. See HUD Handbook 4155.1 REV-5, ¶ 2-13. This Handbook, however, did not become mandatory until January 1, 2004. HUD Handbook 4155.1 REV-4, CHG-1 was applicable at the time the subject loans were originated and closed. The underwriters therefore had discretion to determine what compensating factors existed.

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The subjective nature of the allegations regarding credit in Finding 1 is not limited to those cases involving qualifying ratios and compensating factors. For example, in some cases, the Report alleges that the underwriter did not consider the effects of payment shock or that the number of derogatory accounts reflected in the credit report dictated against loan approval. Creditworthiness, however, is primarily a subjective determination based on a loan applicant's overall credit record that the Department has delegated to Direct Endorsement lenders. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3. To the extent the allegations in Finding 1 involve subjective underwriting decisions rather than compliance with specific documentation requirements, the allegations are misplaced.

Furthermore, Decatur complied with loan origination requirements regarding borrower credit in the cases cited in Finding 1. For example, in the [REDACTED] case, FHA Case No. 151-6387115, the Report alleges that Decatur did not adequately show that the borrower established good credit after a bankruptcy insofar as the Company did not investigate credit inquiries and delinquent accounts were paid off at closing. The Report notes that the underwriter did not explain how the borrower would be expected to make the higher mortgage payments as the buydown period expired. In this case, the borrower's credit report expressly stated that the two inquiries were "non credit" inquiries (**Exhibit G-1**). Thus, further investigation into the inquiries was not required. In addition, Decatur obtained letters of explanation from the borrower regarding the bankruptcy and derogatory items on the credit report (**Exhibit G-2**), and it properly furnished these explanations to the sponsor with the loan package. The underwriter reviewed the borrower's credit report and explanations and determined that the borrower was both creditworthy and willing and able to make mortgage payments. The Trustee in Bankruptcy had given permission for the borrower to incur new mortgage debt (**Exhibit G-3**), and it appears that the borrower had a satisfactory pay history on all accounts included in the Chapter 13 bankruptcy since 1999. Decatur fulfilled its obligation to provide the credit documentation to the underwriter, and the underwriter made the credit decision. To the extent the OIG disagrees with the credit decision in this case, we respectfully submit that the OIG should address its concerns directly with the underwriter.

Similarly, in the [REDACTED] case, FHA Case No. 151-6396198, the Report alleges that Decatur did not show that the borrower had established good credit since a Chapter 13 Bankruptcy discharge in 1999 because a judgment was satisfied in February 2001 and there were three delinquent accounts. The Report further alleges that the credit reports showed the borrower was just under his credit limits, but Decatur did not show the borrower had improved his use of credit and his attitude towards debt, and the bank statements did not show an ability to save funds. The Report also alleges that Decatur did not investigate two inquiries identified on the credit reports. As in the [REDACTED] case,

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the findings in the [REDACTED] case focus on the OIG's disagreement with the underwriting decision, in which Decatur did not participate. Initially, note that the two referenced inquiries were not credit related. One specifically stated that it was a "non credit inquiry" and the other was in connection with the borrower's retention of the current mortgage (**Exhibit H-1**). Thus, further investigation into the inquiries was not required. With respect to the borrower's credit history, Decatur properly obtained detailed letters of explanation from the borrower (**Exhibit H-2**) and furnished them to the sponsor for underwriting review and determination. The Company documented the borrower's payment of a judgment and other late accounts, and it was up to the underwriter to determine whether these items warranted loan approval. Decatur fulfilled its obligation to provide the credit documentation to the underwriter and the underwriter made the credit decision. To the extent the OIG disagrees with the credit decision in this case, we respectfully submit that the OIG should address its concerns directly with the underwriter.

As in the two aforementioned cases, the credit-related findings in the Report involve solely underwriting issues in the [REDACTED] case, FHA Case No. 151-6537560. In this case, the Report alleges that Decatur did not show the borrower was an acceptable credit risk because the credit report showed six delinquent accounts and three civil judgments, which reflects a lack of money management and willingness to pay debts, and the payment of \$6,209 in delinquent accounts at closing did not show an improvement in the borrower's attitude towards debt. The Report further alleges that Decatur did not verify that the borrower's mother was making car payments for the borrower to justify exclusion of this debt from the mortgage credit analysis. Contrary to the suggestion in the Report, it was not Decatur's responsibility to show that the borrower was an acceptable credit risk. Decatur obtained the credit documentation and furnished it to the sponsor, including the credit report (**Exhibit I-1**) and letters of explanation from the borrower explaining that the late payments were due to missed payments while on maternity leave and that the borrower had since obtained new employment with better benefits (**Exhibit I-2**). It was the underwriter's responsibility to review these items and determine whether loan approval was appropriate. Credit analysis is strictly an underwriting function in which loan correspondents are not qualified to engage. Moreover, with respect to the exclusion of car payments from the qualifying ratios, the underwriter, not Decatur, determined the borrower's monthly debt and made the decision to exclude the car payments.

In sum, whether or not the presence of six delinquent accounts and three civil judgments, in light of the payment of debts at closing and letters of explanation, should prevent loan approval was a subjective determination by the underwriter in which Decatur did not participate and over which Decatur had no control. Likewise, whether to include or exclude a particular debt from the borrower's qualifying ratios is a determination made independently by the underwriter when completing the MCAW, not

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the loan correspondent. While we understand that the OIG may disagree with the underwriter's decisions, Decatur obtained the required documentation and performed its duties as a loan correspondent in compliance with FHA requirements.

Like the [REDACTED], [REDACTED] and [REDACTED] cases, the remaining cases cited in the Report that contain alleged deficiencies regarding the borrowers' creditworthiness and ability to make mortgage payments involve subjective underwriting determinations by Decatur's sponsors. Decatur did not participate in and had no control over these determinations. The Company obtained the required documentation in each case and submitted the documentation to the sponsor for underwriting analysis. Please note that, during the 2002 HUD Quality Assurance Division proceeding, the Department recognized that creditworthiness is an underwriting issue and addressed the matter directly with the Company's sponsor (**Exhibit A-3**). Nevertheless, note that Decatur worked with its primary sponsor to implement changes necessary to meet the sponsor's new and tighter underwriting controls, which included, among other things: a prohibition against exceeding the benchmark qualifying ratios of 29% and 41% in transactions involving adjustable rate mortgages and buydowns (regardless of automated underwriting approval); a requirement that borrowers have clean credit for the past 12 months; and a prohibition against loan approval where the borrower had any late payments after a bankruptcy. While Decatur could not participate in the credit underwriting process, it worked hard to ensure prudent mortgage credit analysis by its sponsors.

d. Source of Funds

The Report alleges that Decatur did not properly verify the borrower's source of funds to close in 40 cases. Specifically, it alleges that, in 34 cases, Decatur did not verify the actual source of deposits from the borrower or provide cancelled checks and bank statements to show the cash deposits coming out of the borrower's account. In addition, it alleges that, in 39 cases, although the settlement agents provided the OIG with wire transfer documentation reflecting the transfer of gift funds from nonprofit donors, Decatur did not document the timing of the gift wire transfers from nonprofit donors to the settlement agents and the timing of the contribution from the sellers' proceeds back to the nonprofit donors to ensure that the gift funds were not actually provided by the sellers. Finally, the Report alleges that, in 23 cases, the settlement agent paid off more of the borrower's delinquent debts than cash provided by the borrower, thereby causing part of the gift provided by the nonprofit donor to be used to pay off delinquent accounts rather than being used for the home purchase transaction, without making a corresponding reduction to the sales price and mortgage.

We respectfully disagree with the allegations in these cases. We address the three matters regarding borrowers' source of funds in turn below.

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i. Earnest Money Deposits

With respect to the source of earnest money deposits, FHA guidelines require that, when the earnest money deposit ("EMD") exceeds two percent of the sales price or appears excessive based on the borrower's history of accumulating savings, a lender must verify the deposit amount and source of funds. The guidelines state that HUD will accept two different types of evidence: either, (1) a cancelled check; or (2) a certification from the deposit holder acknowledging receipt of the funds and separate evidence of the source of funds, which may include a verification of deposit ("VOD") or bank statement showing that the average balance at the time of the deposit was sufficient to have included the EMD. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-10(A). Decatur generally complied with these requirements in the cases cited in Finding 1.

For example, in the [REDACTED] case, FHA Case No. 151-6647913, the Report alleges that Decatur did not verify the source of the \$1,718 EMD. In this case, however, the EMD was only one percent of the \$171,815 sales price (**Exhibit J**) and Decatur was not required to obtain evidence of the deposit amount or source of funds. If the underwriter believed that the EMD appeared excessive based on the borrower's history of accumulating savings as determined during the underwriter's mortgage credit analysis, then the underwriter should have requested additional documentation of the EMD prior to loan approval. Similarly, in the [REDACTED] case, FHA Case No. 151-6957663, the Report alleges that Decatur did not document that the borrower actually provided the \$500 EMD. Here, the EMD was less than 0.4% of the \$129,633 sales price (**Exhibit K**). Thus, Decatur was not required to verify the deposit amount and source of funds. If the underwriter believed that the EMD appeared excessive based on the borrower's history of accumulating savings, then the underwriter should have requested additional documentation of the EMD.

Like the [REDACTED] and [REDACTED] cases, in the remaining cases cited in Finding 1 for alleged deficiencies regarding the EMD, Decatur obtained the required documentation and submitted it to the sponsor for underwriting analysis. If additional documentation was needed in any case, the underwriter should have obtained such documentation prior to approving the loan. Moreover, please note that, during the 2002 Quality Assurance Division proceeding, HUD recognized that documentation of the EMD ultimately was the underwriter's responsibility and therefore indicated that this matter would be addressed directly with Decatur's sponsor (**Exhibit A-3**).

ii. Nonprofit Gift Funds

With respect to nonprofit gift funds, contrary to the suggestion in the Report, the lack of evidence regarding the timing of wire transfers of downpayment assistance did

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not constitute a violation of FHA requirements at the time the loans cited in the Report were originated and closed. The Report cites Paragraph 2-10 of the former Mortgage Credit Analysis Handbook, 4155.1 REV-4, CHG-1, for the proposition that evidence of a wire transfer from the nonprofit to the closing agent must be obtained when downpayment assistance is received. Neither the cited provision nor any other FHA provision in force at the time, however, contained any such requirement. Moreover, Page 2-11 of the Department's Single-Family Reference Guide provided that the transfer of downpayment assistance funds could be reflected as a transaction on the HUD-1 Settlement Statement ("HUD-1"). It stated:

When gifts are provided by a nonprofit or municipality through a downpayment assistance program (DAP), the same basic rules regarding documentation of gifts apply. The lender must obtain evidence from the donor (agency) of the amount of funds being provided, as well as evidence that no repayment by the borrower is required. Evidence of the actual transfer of funds can be shown as a transaction on the HUD-1. Costs for processing a DAP may not be included as part of the borrower's cash investment, but may be included in secondary financing.

<http://www.hud.gov:80/offices/hsg/sfh/ref/sfhp2-11.cfm> (emphasis added) (Exhibit L).

Decatur complied with these requirements in the cases cited in Finding 1. The files contain gift letters from the nonprofit donors evidencing the amount of funds being provided and that no repayment by the borrowers was required, and the transfers of funds were shown as transactions on the HUD-1s. See, e.g., Exhibit M. It was not until July 2004, with the issuance of Mortgage Letter 04-28, that HUD required a lender to obtain evidence of the wire transfer when nonprofit gift funds are used. Thus, the allegation that Decatur somehow violated FHA requirements by not obtaining evidence of the wire transfers in the cases cited in Finding 1 is unsupported and should be withdrawn from the final Report. Having said that, please note that, in 38 of the 39 cases where this finding is raised, the Report acknowledges that the downpayment assistance gift funds were in fact wired to the settlement agent prior to the seller's contribution to the nonprofit.

iii. Payment of Delinquent Debts

Finally, with respect to the alleged use of nonprofit gift funds to pay the borrower's delinquent debts in 23 cases, contrary to the allegations in Finding 1, Decatur and the underwriters adhered strictly to HUD/FHA guidelines in place at the

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time the 23 loans were originated. The Report cites Paragraph 2-10 of the Mortgage Credit Analysis Handbook for the proposition that nonprofit gift funds may not be used to pay a borrower's delinquent debts. Nothing in the cited provision, however, addresses this issue. Moreover, it was not until January of 2002, when HUD issued Mortgagee Letter 2002-02, that the Department imposed a prohibition against the use of nonprofit gift funds to pay delinquent borrower debts without making a corresponding reduction to the sales price and mortgage amount.

In Mortgagee Letter 2002-02, HUD expressed the concern that payment of a borrower's debt by a nonprofit entity that receives a contribution from the property seller may result in a riskier mortgage loan. HUD therefore stated that elimination of consumer debt under these circumstances would be prohibited and that gift funds from anyone other than a family member that are used to pay off debts must be treated as an inducement to purchase and reduce the sales price by a commensurate amount in calculating the maximum insurable mortgage. While the Department issued Mortgagee Letter 2002-02 on January 16, 2002, it expressly stated that "the provisions of this Mortgagee Letter will be effective for all case number assignments issued 30 days after the date of this Mortgagee Letter." Thus, the new requirements became effective for FHA Case Numbers ordered on or after February 16, 2002.

Significantly, in 22 of the 23 cases cited in the Report where nonprofit gift funds allegedly were used to pay delinquent borrower debts at closing, the FHA Case Numbers were ordered prior to February 16, 2002. In these 22 cases, Decatur ordered the FHA Case Numbers between August 2001 and January 2002. Thus, the prohibition set forth in Mortgagee Letter 2002-02 did not apply to these transactions.⁴ After HUD issued Mortgagee Letter 2002-02, Decatur changed its policy to adhere to the new requirement. Specifically, the Company began to furnish its sponsors with existing pipeline reports that included the dates that FHA Case Numbers were assigned in order to enable the sponsors to ensure that all loans satisfied the new HUD requirement.

In the remaining case, although the FHA Case Number was ordered after the effective date of Mortgagee Letter 2002-02, contrary to the suggestion in Finding 1, nonprofit gift funds were not used to pay delinquent borrower debts at closing. In the ██████████ case, FHA Case No. 151-6838872, the Report alleges that the HUD-1 reflects that the borrower made a \$1,000 EMD and brought \$3,157 to closing, for a total investment of \$4,157. It alleges, however, that the borrower paid a total of \$3,682 towards delinquent accounts, thereby suggesting that the borrower paid only \$475 towards the transaction with the remainder provided by the nonprofit donor. As recognized in the Report, the borrower furnished \$4,157 in the transaction and had

⁴ Moreover, in certain of these cases, contrary to the suggestion in the Report, nonprofit gift funds were not used to pay delinquent borrower debts at closing.

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\$3,682 in delinquent accounts. Note also that the borrower did not receive any cash back at closing (**Exhibit N**). Thus, the borrower provided enough funds to cover the debts, and the nonprofit gift funds were sufficient to cover the downpayment and closing costs. It therefore appears that the requirements of Mortgagee Letter 2002-02 were satisfied in the [REDACTED] case.

e. Borrower Expenses and Property Taxes

Finding 1 alleges that, in 37 cases, Decatur and the underwriter underestimated the borrower's expenses and property taxes. Specifically, it alleges that, in 12 cases, an expense was indicated in a document not considered in the mortgage credit analysis. It further alleges that, in 36 cases, Decatur and the underwriter estimated a monthly figure for property taxes that was based on the taxes for the undeveloped land, but the actual taxes to be assessed after the sale to the buyers were significantly higher and were not figured in to the borrowers' ability to afford the mortgage. The Report states that the figure Decatur used for property taxes was either \$25 or \$40 per month, but the actual taxes ranged from \$72 to \$279 per month based on information obtained from the counties where the properties were located.

With respect to the 12 cases where Decatur's files allegedly contain information regarding expenses that were not included in the mortgage credit analysis, please note that Decatur furnished all required information and documentation to its sponsors for underwriting analysis. The underwriters, not Decatur, performed the mortgage credit analysis in each transaction and ultimately determined what expenses to consider. To the extent the OIG believes that expenses were improperly omitted in any given case, Decatur would not have been involved in the decision to exclude the expenses and this matter would be better directed to the underwriters who made the determinations.

With respect to the determination of property taxes, Decatur traditionally had included in the loan application package furnished to the sponsor the amount of taxes on the unimproved land. As a loan correspondent, however, Decatur did not determine a borrower's monthly payment amount for principal, interest, taxes, and insurance ("PITI"). The underwriter calculated the PITI on the MCAW and therefore was responsible for estimating the amount of property taxes to include in the PITI. While Decatur noted the unimproved taxes in the files according to the existing tax information for the properties, the underwriters determined what tax amounts to use for qualifying purposes. In its most recent clarification regarding property taxes, the Department recognized this distinction between loan correspondents' duties and underwriters' duties. HUD stated:

Direct Endorsement (DE) underwriters must use accurate estimates of monthly property tax escrows in qualifying

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borrowers. HUD has discovered a number of instances where underwriters, usually on new construction transactions, failed to consider the property taxes once the improvements are valued by the taxing authority and reassessed. The underwriters instead grossly underestimated taxes by using only the appraiser's estimate of the vacant land. . . . Therefore, when qualifying borrowers, DE underwriters must use realistic estimates of the property taxes that reflect the value of the improvements once they are assessed by the units of government to which those taxes are paid. Such estimates may be obtained from reliable sources such as the appraiser, comparable sales data, or the assessor's office.

Mortgagee Letter 04-28 (emphasis added). HUD therefore has recognized that it is an underwriter's responsibility, not a loan correspondent's, to estimate the taxes on the improved land.

Moreover, it was not until July 2004, when HUD issued Mortgagee Letter 04-28, that the Department clarified that a property tax estimate must be based on the value of the improved land for purposes of determining a borrower's PITI on the MCAW. Prior to this Mortgagee Letter, the only provision addressing this issue of which we are aware was contained in the HUD Handbook entitled "Administration of Insured Home Mortgages." See HUD Handbook 4330.1 REV-5, ¶ 2-6. Notably, this Handbook provides "information required to service single-family home mortgages" and "covers all phases of the administration of single-family home mortgages, from the time the mortgage is closed through the time the mortgage insurance is terminated." HUD Handbook 4330.1 REV-5, Forward. Thus, the Handbook does not appear to apply to the loan origination or underwriting process, and it was not until HUD issued Mortgagee Letter 04-28 that it became clear that property taxes included in the borrower's total mortgage payment for qualifying purposes on the MCAW must be based on the value of the improved land.

Although Decatur was not responsible for estimating the property taxes, and while the method for estimating taxes during the underwriting process was not clarified until recently, please note that the Company attempted to address this issue in March of 2003. At that time, Decatur issued a memorandum to Company personnel stating that the property taxes used in any case must be based on the tax certification provided at closing, or one percent of the improved value if no other information is provided, which was a reasonable estimate based on the typical tax rates at the time. Again, however, Decatur did not participate in the underwriting of any loans and had no control over the tax amounts used to qualify borrowers.

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f. Original Documentation

Finally, Finding 1 alleges that, in 10 cases, Decatur obtained wage information, verification letters, and letters of explanation about income and debts from interested third parties. It alleges that these items showed they were faxed from one of the seller's sales offices or from the borrowers' place of employment, rather than directly from the source of the information. Finding 1 further alleges that, in three cases, explanation letters were provided that the seller created for the borrowers and that contained information the borrowers have indicated was incorrect.

We understand and appreciate that credit reports and verification forms may not pass through the hands of interested third parties. Decatur's practice was to accept faxed documentation prior to formal loan application as borrowers prepared for the loan process, but to require the provision of original documents at the time of loan application when Decatur met with the borrowers. In some cases, Decatur may have inadvertently furnished the original items received to its sponsors without making copies for its own records. In addition, as you know, borrowers often meet with loan officers outside of a lender's office in order to accommodate a borrower's work schedule or use facsimile machines made available by sellers, real estate agents and others, to which the borrowers would not otherwise have access, in order to deliver documents to the lender. To the best of our knowledge and belief, in the cases referenced in Finding 1, the borrowers generally used the seller's facsimile machine or equipment owned by their employers. Whether the borrowers personally faxed the documents to the Company or handed the documents to an office assistant to fax, the borrowers themselves would have brought the documents to the seller's or employer's office for delivery to Decatur.

In this regard, we are unaware of any prohibition in force when the subject loans were originated against a borrower furnishing bank statements, pay statements, W-2 forms, letters of explanation, and various other items to a lender, or against a borrower's use of a third party's facsimile machine to do so. Paragraph 3-6 of the Mortgagees' Handbook Application Through Insurance (Single-Family) states: "The credit report and verification forms must not pass through the hands of the applicant, a real estate agent, or other interested third party." (emphasis added). The Handbook references credit reports and verification forms, not bank statements, pay statements, W-2 forms, or letters of explanation, which are the primary types of documents referenced in Finding 1 of the Report. In fact, the Handbook expressly states that the "applicant must provide a copy of his/her most recent pay stub." HUD Handbook 4000.2 REV-2, ¶ 3-6(B)(2) (emphasis added). The Mortgage Credit Analysis Handbook further states that, regarding employment and account documentation, a lender may obtain pay stubs, W-2 forms, and bank statements "from the borrower." HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1(E), (F). It was not until HUD issued the new Mortgage Credit Analysis

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Handbook, effective January 1, 2004, that the Department prohibited the use of any third party's equipment to transmit loan documentation. See HUD Handbook 4155.1 REV-5, ¶ 3-1. Decatur substantially complied with the requirements that were applicable at the time the loans cited in Finding 1 were originated.

For example, in the [REDACTED] case, FHA Case No. 151-6584264, the Report alleges that copies of pay statements and bank statements were faxed to Decatur from the seller's office. The FHA guidelines in force at the time this loan was originated, however, did not prohibit a borrower's use of a third party's facsimile machine to transmit such items to the lender, and the Department had expressly stated that a lender may obtain pay stubs and bank statements "from the borrower." HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1(E), (F). Moreover, the Report does not allege, and there is no reason to believe, that the pay statements or bank statements were somehow deficient in this case. Similarly, in the [REDACTED] case, FHA Case No. 151-6574687, the Report notes a statement by the borrower that he hand carried a letter from his school to Decatur. Again, the FHA guidelines in force at the time did not prohibit the retention of this document from the borrower. It was neither a credit report nor a verification form. Moreover, the borrower did not claim that the document was false, but merely that he furnished it to the Company in order to confirm prior education, and this item did not affect the borrower's income, assets or credit. The remaining eight cases where documents were faxed from equipment belonging to a third party involve similar circumstances.

With respect to the three cases where the Report alleges that the seller created letters of explanation for the borrowers containing incorrect information, please note that Decatur had no reason to suspect that the information it received was inaccurate. The borrowers furnished the documentation and represented that it was true and accurate. If the explanations were incorrect, the borrowers should not have provided them. Decatur, however, had no reason to question the borrowers' veracity.

For example, in the [REDACTED] case, FHA Case No. 151-6605466, the Report alleges that the seller provided the borrower with a lease form that the borrower completed, but that the borrower now claims the lease was invalid. As explained above in Part II.A.2.a., Decatur properly obtained a copy of the rental agreement in this case and had no reason to suspect its integrity. If the lease was invalid, the borrower should not have completed and executed it. Decatur, however, neither knew nor should have known that the information was incorrect. Similarly, in the [REDACTED] case, FHA Case No. 151-6574687, the Report alleges that a letter of explanation regarding past due accounts was typed by Decatur's loan officer and that the borrower now claims the letter is false. As you may know, loan officers often type letters of explanation for borrowers based on the information borrowers provide, especially when a borrower does not have easy access to a computer or typewriter. Here, while the loan officer may have typed

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the letter, the information in the letter was based on information provided by the borrower. Finally, in the [REDACTED] case, FHA Case No. 151-6589970, the Report alleges that a letter of explanation regarding the borrower's short pay period contained incorrect information and that he was unaware of the letter or who prepared it. In this case, Decatur received the referenced letter of explanation among a number of documents provided by the borrower. Decatur is unsure of the borrower's recent claim regarding the authenticity of this letter, but the Company had no reason to suspect its integrity at the time of loan origination.

In sum, Decatur reasonably relied on information and documentation furnished by the borrowers in the three aforementioned cases. In no case did Decatur participate in the creation of inaccurate file documentation, and it had no reason to question the borrowers' representations. Moreover, while Decatur understands and appreciates the Department's requirements regarding original documentation, it is ultimately an underwriter's responsibility to ensure that a file does not contain documentation improperly handled by third parties. The Department recognized as much in the 2002 Quality Assurance Division proceeding when it indicated that this matter was being addressed directly with the Company's sponsor (**Exhibit A-3**).

3. The Recommendations in the Report are Disproportionate to the Alleged Deficiencies

Based on allegations that there were loan origination and underwriting deficiencies in 41 cases, the OIG recommends that HUD not only require indemnifications from Decatur and/or its sponsors, but that HUD take administrative action against Decatur's owners. As detailed above, however, most if not all of the allegations in Finding 1 involve underwriting concerns in which Decatur did not participate, over which Decatur had no control, and that require resolution by the Company's sponsors. Not only do FHA guidelines expressly define the matters raised in Finding 1 as underwriting functions that loan correspondents cannot perform, but the Department recognized that such matters ultimately are the responsibility of Decatur's sponsors in the 2002 Quality Assurance Division proceeding. Moreover, to the extent the Department may determine that Decatur was responsible for any of the matters raised in Finding 1, administrative action against Decatur's owners would be inappropriate. Such a measure typically is invoked where fraud or misrepresentation is present, not in situations where the only allegations involve loan origination or subjective underwriting decisions. This recommendation is grossly disproportionate to the alleged violations in Finding 1 and, we hope you will agree, should be removed.

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B. FINDING 2 – DECATUR HAD SUFFICIENT MANAGEMENT OVERSIGHT AND PERFORMED QUALITY CONTROL

In Finding 2, the report alleges that Decatur did not adequately implement its Quality Control process according to HUD's requirements. Specifically, it alleges that Decatur did not review 14 loans that defaulted within the first six payments after closing, six of which were included in HUD's September 2002 Quality Assurance review, or adequately document what analyses were performed and what documentation was analyzed or verified for the FHA mortgage loans reviewed. The Report attributes these alleged deficiencies to an ownership relationship with the seller of the subject properties and a disregard of Quality Control requirements. The Report further alleges that, while Quality Control reviews were performed on three of the 41 loans referenced in the Report, the reviews did not identify the origination issues that the OIG noted. The Report recommends that HUD determine whether any action against Decatur's sponsors would be appropriate.

Contrary to the suggestion in the Report, Decatur took Quality Control seriously since its inception. As part of the Operating Agreement between HFN and Dura Homes, HFN performed Quality Control reviews of a random sample of the loans produced by Decatur to ensure compliance with applicable regulatory and investor requirements. To this end, HFN created a detailed Quality Control Plan for Decatur (**Exhibit O**), which complied with the then-existing FHA requirements and on which HFN relied in performing reviews of Decatur's loans. Specifically, HFN reviewed Decatur's operational matters concerning office structure and location, employees, advertising, reporting, records retention, and other issues. In addition, in compliance with FHA requirements in force at the time, see HUD Handbook 4060.1 REV-1, Chapter 6, HFN reviewed at least 10% of Decatur's closed FHA loans each month to ensure compliance with requirements concerning, among other things:

- disclosures (e.g., Good Faith Estimates, Truth in Lending disclosures, Equal Credit Opportunity Act disclosures, Real Estate Settlement Procedures Act disclosures, lock-in agreements, escrow disclosures and statements, etc. . . .);
- credit documentation (e.g., sales contracts, loan applications, credit reports and explanations, etc. . . .);
- employment and income documentation (e.g., verifications of employment, pay stubs, W-2 forms, etc. . . .);
- source of funds documentation (e.g., verifications of deposit, bank statements, gift funds, etc. . . .);

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- verifications of rent or mortgage;
- appraisals;
- occupancy;
- underwriting approval/denial;
- re-verifications;
- legal and closing documents (e.g., Mortgage, Note, Deed of Trust, etc. . . .); and
- customer satisfaction.

HFN furnished written Quality Control reports each quarter, and it worked with Decatur to identify issues and implement appropriate changes.

Nevertheless, the Report alleges that Decatur did not document what analyses were performed and what documentation was analyzed or verified for the FHA mortgage loans reviewed. In performing Quality Control reviews, HFN performed the analyses and analyzed/verified the documentation set forth in the Quality Control Plan (**Exhibit O**). The plan provided substantial detail regarding each item reviewed and the specific analysis performed regarding that item, and HFN adhered to the Quality Control Plan in connection with its reviews of Decatur's files. While HFN did not repeat the lists of items reviewed and analyses performed in every Quality Control report it prepared for Decatur, note that HFN was not required to do so.

With respect to Quality Control reports, the HUD Handbook in effect at the time provided: "The Quality Control Plan must require written notification to the mortgagee's senior management, at least quarterly, of deficiencies cited as a result of the file. Where possible discrimination is noted, the mortgagee is expected to take immediate corrective action." HUD Handbook 4060.1 REV-1, ¶ 6-1(G). Decatur complied with this requirement. HFN issued Quality Control reports at least quarterly, and the reports identified any deficiencies cited in the files reviewed. When deficiencies were identified, the reports described the specific deficiencies and identified the documentation involved. The Department, however, did not prescribe the form or content of reports to senior management and it did not require that the reports describe the specific analyses performed or the individual documents analyzed or verified. The only requirement regarding the content of the reports was that the reports identify deficiencies cited in the files. Thus, while we appreciate the OIG's position that more detailed reports may have

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been helpful, Decatur met FHA requirements regarding the contents of Quality Control reports.

HFN not only issued Quality Control reports, but it worked with Decatur to correct any noted deficiencies. For example, as explained above, Decatur implemented a number of changes at the Company beginning in February 2002. Among other things, Decatur:

- hired a new Branch Manager and branch office personnel;
- required the new Branch Manager to review all loan applications prior to submitting them to loan sponsors for underwriting and approval;
- discontinued its acceptance of downpayment assistance funds from HART;
- reviewed the types of FHA loans it originated to identify any correlations between the types of loans and the Company's default/claim rates; and
- worked with its primary sponsor to implement changes necessary to meet tighter underwriting controls that the sponsor initiated, including:
 - a cap on qualifying ratios at 29% and 41% in connection with adjustable rate mortgages and temporary buydowns;
 - a requirement that borrowers have good credit for at least the past 12 months, regardless of approval by an automated underwriting system;
 - a requirement that three compensating factors expressly accepted by HUD be documented for borrowers with credit scores below 585 and/or back-end ratios that exceed 41%; and
 - a prohibition against loan approval for borrowers with any late payments following a bankruptcy.

Such Quality Control efforts successfully resulted in a decrease in Decatur's default/claim rate and demonstrated Decatur's commitment to Quality Control.

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The Report further alleges that, while Quality Control reviews were performed on three of the loans referenced in the Report, the reviews did not identify the same origination issues that the OIG identified. The fact that HFN did not identify the same issues as the OIG does not suggest that the Quality Control reviews of the files were necessarily deficient. For example, in the [REDACTED] case, FHA Case No. 151-6510827, the Report alleges that HFN performed a Quality Control review of the file but did not identify the deficiencies alleged in the Report. Significantly, however, we disagree with the allegations set forth in Finding 1 in this case.

The Report makes five allegations in the [REDACTED] case. First, it alleges that while Decatur's file contained a receipt from the seller showing that the borrower made a \$10,000 EMD, the HUD-1 did not give the borrower credit for the EMD and the file did not identify the source of the EMD. The borrower did not receive credit for the EMD in this case because the seller never deposited the funds. The borrower received a \$20,000 gift from his mother-in-law, as recognized in the Report, which was used to cover all funds needed in the transaction.

Second, the Report alleges that Decatur did not establish that the borrowers had improved their attitude towards credit and were acceptable credit risks because there were 19 delinquent loans and accounts in collection and the borrower paid \$5,074 in debts at closing. While we appreciate that the Department may disagree with the underwriter's determination of creditworthiness in this case, there was no violation of any FHA requirement. The underwriter reviewed the credit documents and exercised the discretion granted to it by the Department in determining that the borrower was creditworthy.

Third, the Report alleges that Decatur and the underwriter used an unreasonably low estimate of property taxes based on the taxes for the undeveloped land. While we now understand that the borrower's total mortgage payment should include a tax estimate based on the assessed value of improved land, the underwriter was responsible for determining the amount of taxes to use in completing the MCAW and calculating the borrower's total mortgage payment for qualifying purposes. Moreover, it was not until HUD issued Mortgagee Letter 04-28 in July of 2004 that it became clear that an underwriter must estimate property taxes based on the improved land in determining a borrower's PITI on the MCAW.

Fourth, the Report alleges that the credit reports reflected more than one Social Security Number ("SSN") for each borrower, but that Decatur did not investigate the SSNs. Although the credit reports appear to reflect more than one SSN for each borrower in this case, as a loan correspondent, Decatur did not review and analyze the credit reports. FHA guidelines expressly state that mortgage credit analysis is an

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underwriting function that loan correspondents cannot perform. See, e.g., HUD Handbook 4000.4 REV-1, CHG-2, ¶¶ 1-2(B), ¶ 2-13.

Finally, the Report alleges that the appraiser did not adequately justify the use of three comparable properties that were over a mile from the subject property and two comparable properties that were sold over six months prior to the appraisal. As previously noted, FHA guidelines expressly state that appraisal review is an underwriting function that loan correspondents cannot perform. See, e.g., HUD Handbook 4000.4 REV-1, CHG-2, ¶¶ 1-2(B), ¶ 2-13. Thus, the underwriter, not Decatur, reviewed the appraisal report in this case and was to ensure that it satisfied HUD/FHA requirements. Nevertheless, the appraisal appears to comply with FHA guidelines. HUD does not prohibit the use of comparable properties more than one mile from the subject property or the use of comparable properties sold more than six months, but less than one year, prior to the appraisal if more recent ones are not available, so long as the appraiser explains his or her decision to use such comparable properties. See, e.g., HUD Handbook 4150.1 REV-1, ¶ 8-3(O)(3); HUD Handbook 4150.2, CHG-1, Appendix D-1.

In sum, in the [REDACTED] case, while we agree that the Quality Control report should have identified the discrepancy regarding the borrowers' SSNs, the other findings in the Report do not allege violation of any particular FHA requirement(s) and we disagree that the alleged deficiencies required notation in the Quality Control report. The remaining two files for which the Report alleges deficiencies that were not identified in Decatur's Quality Control reviews involve similar circumstances.

Finally, regarding the review of early payment defaults ("EPDs"), although Decatur did not review EPDs for a period of time, this deficiency did not result from a disregard for Quality Control requirements. As explained both to HUD during a Quality Control proceeding in November 2002 and to the OIG during its audit, the early failure to review EPDs resulted from non-servicing lenders' inability to gain access to payment histories on loans they originated. It was not until mid-2002 that HUD began posting EPDs on FHA Connection/Neighborhood Watch. Prior to that time, because Decatur was a loan correspondent and did not service the loans it originated, it did not have access to loans' payment status. The Company's ability to monitor the default status of the loans it originated depended on whether the loans' purchasers timely notified the Company that a loan had gone into default or foreclosure. As you may know, however, despite requests by loan originators, many servicers routinely fail to keep originators apprised of borrowers' payment histories. This problem was not unique to Decatur, but is common throughout the mortgage lending industry. Moreover, as a result of relatively new privacy laws, some servicers have flatly refused such requests for information. Consequently, Decatur did not have access to EPDs until HUD made the information

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available on FHA Connection/Neighborhood Watch and its review of EPDs therefore was delayed.

Despite early difficulties obtaining payment information on the loans it originated, Decatur began to perform Quality Control reviews of EPDs once the information became available through FHA Connection/Neighborhood Watch. Beginning in November 2002, HFN reviewed all loans that had gone into early payment default status as of the end of 2001 and ensured the review of all EPDs on a going-forward basis. Any prior deficiency in connection with this matter was addressed and resolved. Moreover, as part of the 2002 Quality Assurance Division proceeding, HUD identified the same issue regarding Quality Control reviews of EPDs (**Exhibit A-1**). Significantly, in May 2003, HUD issued a final letter to Decatur indicating that the Quality Control findings were considered resolved (**Exhibit A-3**).

III. CONCLUSION

The Report portrays Decatur as a poorly managed loan correspondent that disregarded loan origination requirements and failed to perform satisfactory Quality Control. This characterization is unfair, untrue, and unsupported by the evidence in this case.

Contrary to the suggestion in the Report, Decatur established effective management supervision and controls, substantially complied with FHA loan origination requirements, and performed Quality Control. With respect to management supervision and controls, Decatur's Branch Manager was responsible for supervising and evaluating branch office operations, and HFN provided ongoing management support. Although Dura Homes, one of Decatur's members, had common ownership with the seller of the subject properties, Dura Builders sold properties financed by mortgagees other than Decatur and this relationship in no way tainted the Company's loan originations or affected its compliance with Quality Control requirements. Decatur took its loan origination and Quality Control responsibilities seriously and made loan origination decisions based on the quality of loan applications, not the identity of the seller. Moreover, the specific findings in the Report are largely incorrect.

With respect to Finding 1, as is typical of mortgage brokers/loan correspondents, Decatur took borrowers' loan applications and gathered information and documentation to submit to its sponsors for underwriting analysis. Decatur obtained the required documentation in each case, and the underwriter determined whether the documentation was sufficient to approve the FHA loan. Because the Department does not permit loan correspondents to review appraisals or perform mortgage credit analysis, the matters raised in Finding 1 relate to underwriting issues that were the responsibility of the Company's sponsors. The Report not only cites FHA guidelines

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that were not in force at the time the loans referenced in the Report were originated, but reflects an apparent misunderstanding of the inherent differences between loan correspondents and underwriters and erroneously suggests that Decatur and/or its principals should be penalized for deficiencies that were resolved during a HUD Quality Assurance Division proceeding in 2003 and that the Department determined were ultimately the responsibility of the Direct Endorsement lenders that approved the loans. The Report suggests draconian penalties for infractions that, even if true, would result in lesser penalties imposed by HUD. For these reasons, we respectfully submit that, to the extent the OIG has any concerns regarding the matters raised in Finding 1, the concerns should be directed to the underwriters that approved the loans.

With respect to Finding 2, Decatur ensured the performance of stringent Quality Control since its inception. It adhered to a detailed Quality Control Plan and outsourced Quality Control reviews to HFN. HFN routinely reviewed at least 10% of Decatur's closed loans and issued Quality Control reports on at least a quarterly basis. The reports identified any deficiencies noted during the Quality Control reviews, and HFN worked with Decatur to implement any corrective actions necessary to improve loan origination performance. Although Decatur did not review early payment defaults until November 2002, any deficiency in connection with this matter resulted not from a disregard for Quality Control requirements, but from the Company's inability to obtain loan status information from servicing lenders. Decatur ensured the review of early payment defaults once the information became available through FHA Connection/Neighborhood Watch. Any past deficiency in connection with this matter was resolved, as acknowledged by HUD in May 2003. Decatur identified and responded to Quality Control concerns and exercised responsible management supervision, as evidenced by a lowering of the Company's default/claim rate following the implementation of various corrective actions.

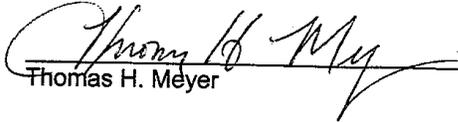
While we recognize that there is always room for improvement, Decatur substantially complied with FHA requirements in connection with the matters raised in the OIG report and at no time intentionally circumvented HUD/FHA rules or regulations. As you know, however, for reasons unrelated to the OIG audit, Decatur voluntarily withdrew its FHA approval and dissolved the Company in November 2003.

Throughout this proceeding, we hope the OIG will consider this response and supporting documentation. We trust that, after reviewing these materials, you will agree that the penalties recommended in the Report are disproportionate to any deficiencies that may have occurred and that the imposition of such penalties against Decatur and/or its owners would be unwarranted in this instance. If you have any questions concerning the matters discussed herein, please contact Decatur's Washington counsel, Phillip L. Schulman, at (202) 778-9027.

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Thank you for your kind consideration.

Sincerely,


Thomas H. Meyer

Paul Shoopman

**Decatur Mortgage Company, LLC
Management Committee Members**

Enclosures

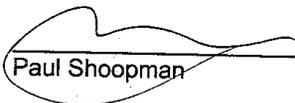
cc: Phillip L. Schulman, Esq.

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Thomas H. Meyer



Paul Shoopman

**Decatur Mortgage Company, LLC
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cc: Phillip L. Schulman, Esq.

OIG Evaluation of Auditee Comments

Decatur's overall response was that it followed HUD's requirements in effect at the time in gathering information. Additionally, that it was the responsibility of the sponsor and its underwriters in how they analyzed the information provided and for the decision to approve the loans we cited in this report. Decatur's owners asserted that they provided adequate oversight of Decatur, took corrective actions, and voluntarily closed its operations. Therefore, the owners should not be held responsible for any technical origination deficiencies along with the sponsor's analysis and loan approval decisions. Decatur's owners also maintained that they performed adequate Quality Control Reviews over Decatur's loans and although they did not document what was done during each review—they were not specifically required to do so. Decatur's owners also stated that corrective actions they and their sponsor took served to lower Decatur's default rate.

We agree that the sponsors are primarily responsible to HUD for the actions of loan correspondents; however, the correspondents are still responsible for the origination and processing that they perform on behalf of the sponsors and HUD/FHA. We cited HUD's regulations and requirements in the findings of the report as necessary. In addition to specific HUD/FHA requirements, loan correspondents and sponsors are required to follow prudent lending practices. The corrective actions that Decatur's owners indicated were required by the sponsor were basically already prudent lending practices that Decatur and its sponsor should have followed. Despite discontinuing the use of the Homeownership Action Resource Trust for homebuyer assistance, Decatur continued using the Nehemiah program for homebuyer assistance.

At the time we selected the 41 defaulted loans for review, Decatur's default rate for the period September 1, 2001 through August 31, 2003 was 8.1 percent, while the National average was only 2.16 percent and for the State of Indiana State it was 3.09 percent. For the period July 1, 2002 through June 30, 2004, Decatur managed to lower its default rate to 6.27 percent while the National rate was 1.84 percent and the State rate was 2.84 percent. These rates demonstrate that while Decatur improved its performance, it still experienced a much higher than average default rate.

Decatur's owners asserted that HUD's Quality Assurance Division already addressed the issues we cited with Decatur's sponsor for eight of the loans cited in this report. We included those eight loans in our review because at the time of our audit, HUD was entering into an indemnification agreement with the sponsor. HUD and the main sponsor did not enter into an indemnification agreement for the eight loans until August 12, 2004.

We modified the wording in our findings as needed to clarify who was responsible for what actions and modified our recommendations as necessary. HUD's management needs to address the loans we cited with the sponsors, but we also believe that HUD needs to consider the issues we identified with Decatur's owners in any possible future applications to originate FHA-insured loans.

Decatur's owners disagreed with this finding. The owners asserted that they provided adequate management oversight and never submitted documentation that they knew to be deficient. The owners stated that as a loan correspondent, Decatur did loan processing by obtaining information and the sponsor's underwriters were responsible for the analysis of the documentation provided. The owners maintain the issues we cited were underwriting issues that should be addressed with its sponsors.

We disagree that Decatur's owners adequately oversaw operations as we discussed in the second finding of this report. We agree that the sponsors are primarily responsible to HUD/FHA for the actions of its loan correspondents and for the underwriting approval decisions.

As a loan correspondent, Decatur Mortgage Company was responsible to HUD/FHA and the sponsors for the application process and, the obtaining and processing of documentation in accordance with FHA's requirements and prudent lending practices. To a large degree, sponsors rely on information provided by loan correspondents in performing the underwriting analysis.

As we cited in the first finding, Decatur processed loan applications that overstated or provided unverified income, and understated expenses. Decatur failed to adequately document the actual source of borrower funds and allowed gift funds provided by non-profit donors to pay-off delinquent debts of the borrowers. Decatur allowed interested third parties to provide documentation and tended to use the same appraiser for its loans. Although the sponsor is primarily responsible to HUD, our analysis of Decatur's delinquent loans as a whole did not show that Decatur's staff was using prudent loan origination practices to gather information for the sponsor's underwriters. We modified our finding to clarify lender responsibilities and modified our recommendations as needed.

Verifying / Supporting Income and source of Funds

Decatur's owners asserted that FHA does not require loan correspondents to analyze employment or financial documentation to determine the effective income or assets for closing. This analysis is done by the underwriter and not the loan correspondent. The owners assert that the income issue is related strictly to underwriting the loan—not to origination or processing.

Decatur's owners stated that in FHA Case number 151-6605466, Decatur properly obtained a rental agreement and a copy of a rent check from the borrower and had no reason to question the borrower's veracity. The homebuilder's sales agent confirmed that the borrower herself furnished the rental information and the sales staff had no knowledge of misinformation.

Decatur's owners stated that for FHA Case number 151-6542156, Decatur properly obtained copies of the Social Security benefits letters and the loan application disclosed the ages of the borrower's children. The underwriter decided how to treat the income. The underwriter grossed up the income in accordance with HUD's rules on nontaxable income.

We do not agree with Decatur's assertions. In FHA Case number 151-6605466, Decatur obtained a rental agreement dated the day of the subject property sales agreement and a copy of an uncashed check. The bank statements did not show any such rental payments received by the

borrower and no explanation was obtained. We agree that the sponsor's underwriter is responsible for rejecting this loan if there is evidence that the rental income was not being received, but Decatur did not meet its obligations to the sponsor and HUD to properly verify income. In this Case, the only documentation Decatur provided was a lease and a copy of the front of a personal check. The bank statements did not show such a check deposited so the evidence provided was inadequate. The fact that Decatur's owners had to verify the provision of the check and lease with the seller's agent demonstrates that Decatur may have obtained this documentation from the seller's agent and not from the borrower.

In FHA Case number 151-6542156, the Social Security income was for two children that were approaching the age of 18. According to documents in Decatur's loan file, this income was due to their deceased father and not due to a disability. Social Security income was nontaxable so the amount verified by the Social Security Administration was a gross amount and not net. As such, grossing up an additional 25 percent was improper. The grossed up amount was provided to the sponsor on the loan application prepared by Decatur. It was Decatur's error to report the grossed up income on the application and the underwriter's error in not reducing the income or eliminating it from the mortgage credit ratio analysis due to its short-term duration.

Appraisals

Decatur's owners asserted that a loan correspondent initiates/orders the appraisals, but does not evaluate the appraisals. They also stated appraisal evaluation is an underwriting function and not that of a loan correspondent. Decatur's owners asserted that lenders and correspondents are only responsible for identifying appraisals they knew or should have known were defective. Decatur did not know nor should have known of any deficiencies with comparable sales for any of the cited appraisals.

Decatur's owners asserted that there is no prohibition against using two comparable properties in the subject' subdivision and the use of comparables over a mile away or over six months old was explained by the appraiser. In the five cases cited in our first finding where appraisals were adjusted upwards, Decatur did not condone an increased value without support for the higher valuation. It was the underwriter's responsibility to ensure that the appraiser's conclusions were acceptable.

We agree that the primary responsibility for reviewing the appraisals rested with the sponsor. We modified the wording as appropriate in the report. Although Decatur maintains that it did not condone unsupported increases in appraisal valuation, we noted that for FHA Case 151-6485246, a Decatur employee faxed a request to the appraiser that stated "new sales price \$153,116 please adjust appraisal closing at 2:00 today". The appraiser subsequently increased the appraised value. This indicates that Decatur's staff was able to request and obtain changes in appraisals based on changes in the sales price. We modified our recommendations to include HUD reviewing the appraisals on the cases we mentioned in this report to determine if the appraisals were defective, and to take any actions deemed necessary against the appraiser and sponsor.

Borrower Credit

Decatur's owners responded that in the cases we cited in our report, Decatur obtained and provided adequate documentation to the sponsor, and the sponsor's underwriter made the determination whether the borrower's credit was worthy of loan approval. Decatur also stated the credit report inquiries were not credit inquiries, and did not require investigation.

We agree that the sponsor's underwriter was primarily responsible for the underwriting approval of these loans. Decatur, as a loan correspondent, was responsible for fully processing loan applications and submitting loans to the sponsor that met HUD's requirements. For FHA Case number 151-6387115 cited by Decatur's owners, the credit inquiries were by Wireless Finance and Ameritech Small Business. Even though these inquiries may not have been from a lending institution, they could still represent possible delinquent accounts or other debt. At closing for this loan, Decatur had more of the borrower's delinquent accounts paid-off than was actually provided by the borrower. Although the decision to approve this loan was ultimately the sponsor's underwriter, Decatur had a responsibility to submit only loans to the sponsor that showed acceptable credit histories.

For FHA Case number 151-6396198 cited by the owners, the credit report inquiries were from a credit bureau and a mortgage inquiry. These inquiries all represent possible credit that should have been researched.

A recurring problem we cited in our first finding was delinquent accounts being paid-off at closing from closing proceeds. Paying off delinquent accounts at closing does not reflect well on the credit worthiness of a borrower. It is true the sponsor's underwriter was ultimately responsible for the decision to approve the loans cited, but Decatur's agreement with its sponsor required loans to comply with FHA's requirements before submission. Decatur was responsible for the processing of these loans and the decision that it was acceptable to be approvable by the sponsor.

Source of Funds

Decatur's owners responded that in the cases we cited in our first finding, the earnest money deposits were less than two percent of the sales price and did not require verification. They said if the deposits appeared excessive based on the borrower's savings history, the sponsor's underwriter should have requested additional documentation of the earnest money deposits.

Regarding nonprofit gift funds, Decatur's owners asserted that HUD Handbook 4155.1 REV-4, CHG-1, nor any other FHA provision required evidence of a wire transfer from nonprofits to the closing agents. They asserted that HUD's Single Family Reference Guide states the transfer of down payment assistance funds could be reflected as a transaction on the HUD-1 Settlement Statement.

We disagree with Decatur's response. For the loans we cited in this report, the borrowers did not demonstrate any history of savings—thus Decatur should have documented the earnest money deposits during the loan processing. HUD Handbook 4155.1 REV-4, Section 2-10, requires lenders to document fund transfers from the donor to the borrower. Lenders must obtain verification the closing agent received the gift funds from the donor. We agree the underwriter

should have required Decatur to obtain such documentation, but it was still Decatur's responsibility to the loan processor to gather the documentation.

The closing agent lacked documentation of the wire transfers to and from the nonprofit donors. We obtained the documentation directly from the closing agent's bank. In only one case—FHA Case number 151-6463779—the nonprofit donor provided the gift funds after the seller's contribution was sent to the nonprofit. In this Case, the seller provided the gift funds in violation of HUD's requirements. Such verification was a loan processing requirement and the sponsor should have required verification by Decatur.

The Single Family Reference Guide referred to by Decatur's owners was dated November 27, 2001. The Guide refers to Mortgagee Letter 2000-28. The Letter required donors to show that gifts to homebuyers did not come from interested parties, and made lenders responsible to obtain verification the closing agent received funds from the donor. Mortgagee Letter 2002-2 dated January 16, 2002 states when a seller or a nonprofit pays a homebuyers consumer debt to meet debt to income ratios, this is an inducement to purchase and is not acceptable underwriting. The underwriter is ultimately responsible for the mortgage credit analysis. However, Decatur processed the loans that allowed nonprofit donors to pay-off borrower debts and sellers to provide gift funds without documenting if this occurred after the receipt of funds from the donor.

Payment of Delinquent Debts

Decatur's owners asserted they complied with FHA's guidelines in place at the time for using nonprofit gift funds to pay borrower delinquent accounts. The owners claimed HUD did not prohibit gift funds to be used to pay-off borrower's delinquent debts at closing until after February 16, 2002—after the FHA Case numbers were ordered. The owners cited FHA Case number 151-6838872 as a Case where the gift funds were not used to pay-off borrower debts.

Decatur's owners are correct about the date of HUD's prohibition on the practice of using gift funds to pay-off borrower's delinquent debts; however, the funds had to be used to pay-off delinquent debts reflects on the borrower's credit worthiness. For FHA Case number 151-6838872, the borrower only provided \$475 toward the transaction after paying off bad debts. This amounted to only .03 percent of the \$170,412 sales price. This Case was not one of the 23 Cases we cited where gift funds were used to pay-off bad debts.

Borrower Expenses and Property Taxes

We do not agree that Decatur was not responsible for the issues cited in this audit report. As a loan correspondent, Decatur was responsible for processing the loan application for submission to the sponsor. Since Decatur prepared the application form, it made the decision on the estimate of taxes and expenses to provide to the sponsor.

The purpose of the mortgage credit analysis is to determine whether the loan applicant will be able to afford the anticipated mortgage payments and other expenses. To estimate taxes at a level paid by the developer on undeveloped land rather than what the borrower would be expected to pay is not a reasonable estimate—regardless of what is specifically prohibited by

HUD's regulation. Any monthly expenses omitted from the loan application were improper. The sponsor was responsible for the underwriting of the loans but must—to a large extent—rely on information provided by the loan correspondent. In these cases, Decatur failed the sponsor and HUD by providing low tax estimates, and failed the loan applicants in cases where the ability to pay their mortgage and living expenses was borderline.

Documentation Provided by Interested Third Parties

Decatur's owners asserted that credit reports and verification forms may not pass through the hands of interested third parties, but they were not aware of any prohibition against borrowers furnishing bank statements, pay statements, W-2 forms, letters of explanation, and other items by using a third parties fax machine. Handbook 4000.2 REV-2 only cited credit reports and verification forms as examples of what interested third parties were not allowed to handle. Decatur's practice was to accept faxed documentation prior to formal loan application, but require original documents at the time of the loan application when Decatur met with the borrowers. Decatur's owners stated HUD did not prohibit the use of a third party's equipment to transmit loan documentation until January 2004.

Decatur's owners stated that in the three cases where our report cited incorrect letters of explanation created by the seller, Decatur had no reason to suspect the information was inaccurate. The owners asserted the borrowers furnished the documentation and represented that the information was correct. The owners stated it is ultimately an underwriter's responsibility to ensure that a file does not contain documentation improperly handled by third parties.

We agree the sponsor's underwriters were responsible for approving the loans when file documents showed that they were faxed from the seller's office. If the loan correspondent obtained original documentation from the borrowers after receiving a faxed copy, we would not have cited the issue. If Decatur's loan officer received the documentation from the borrower during a face-to-face interview, there would not have been a reason to fax it from the seller's office.

W-2 statements and letters of explanation are key documents supporting the amount of earnings and why past delinquencies arose. Even if HUD had not specifically cited the documentation type in past mortgagee letters or handbooks, prudent lending practices would require the loan officer to be absolutely sure that the documentation was provided by the borrower and not fabricated by the seller or someone else with an interest in the transaction. A document faxed in from a seller or real estate agent does not show that the borrower provided the documentation or knew about the documentation. For FHA Case number 151-6589970, Decatur asserted that the borrower provided the letter of explanation about a short pay period. However, the borrower said the letter was wrong and he had never seen it before. The sponsors are ultimately responsible to HUD for the actions of their loan correspondents, but Decatur did not properly follow prudent lending practices in obtaining all documentation for submission to the sponsor.

Finding 2

Decatur's owners disagreed with the second finding of this audit report.

Decatur's owners asserted that Decatur's Branch Manager oversaw the operations of Decatur's staff, and the managing owner—Homebuilders Financial Network—provided management support. The owners indicated Homebuilders Financial Network performed Quality Control Reviews over at least 10 percent of Decatur's loan originations each quarter in accordance with its approved Quality Control Plan. Decatur's owners stated they followed the requirements of the Quality Control Plan in all Cases reviewed, but were not required by HUD to repeat the lists of items reviewed or show the analysis done and documents verified in each Case reviewed. HUD only requires quality control reports to identify deficiencies identified and cited. The owners asserted the deficiencies identified in this report were underwriting issues that Decatur was not responsible for. Furthermore, they said the Quality Control Reviews were not deficient because they did not identify the same issues. Decatur's owners also asserted they were not given access to early default information in HUD's Neighborhood Watch System until mid 2002.

Although Decatur's owners said they followed their approved Quality Control Plan, they had no documentation to show what they did for the Cases they reviewed. HUD's Mortgagee Approval Handbook 4060.1 REV-1, dated September 1993, paragraph 6-3(D), requires the quality control reviewers to obtain new credit reports. Paragraph 6-3(E) of the Handbook requires the quality control plan to provide for the written reverification of the mortgagor's employment, deposits, gift letter, or other sources of funds. These requirements indicate the quality control reviewer will be obtaining documentation needed to perform the reviews. The sole documentation that Decatur's owners were able to provide for each loan reviewed was a one-page summary report showing that Decatur did a good job, or showing what minor problems were identified and corrected. Decatur's owners said they did everything required by the Quality Control Plan for all loans reviewed, but had no support for what was specifically reviewed for each loan. If a lender does not document what they did to verify whether the loan origination and processing was done correctly, HUD and the lender lack assurance that the lender was prudent in conducting its reviews and it becomes difficult to follow-up on corrective actions taken.